

PETITION

Introduction

The Jewelers Vigilance hereby petitions the Federal Trade Commission to amend the Guidelines for the Jewelry, Precious Metals and Pewter Industries to include the requirement of disclosure of laser drilling of diamonds. The following document sets out the basis for this revision.

The trade associations that endorse mandating disclosure of laser drilling of diamonds in the FTC Guides are:

- World Federation of Diamond Bourses
- Diamond Manufacturers and Importers Association of America
- International Diamond Manufacturers Association
- Diamond Promotion Services
- Diamond Dealers Club of New York
- Gemological Institute of America
- International Society of Appraisers
- U.S. Carat Club
- Jewelers of America
- American Gemstone Society
- American Gem Society
- United States Carat Club
- International Confederation of Jewelry, Silverware, Diamonds, Pearls and Stones (CIBJO)
- American Gemstone Trade Association
- Manufacturing Jewelers and Suppliers of America
- International Standards Organization
- Diamond High Council

The jewelry industry is the beneficiary of numerous trade associations, each one representing different segments of the industry, each one with a separate mission to achieve. It is not unusual for there to be a lack of consensus on particular issues - this industry is made up of entrepreneurs who occasionally take positions on industry issues based primarily on particularized business interests. However, on the issue of disclosure of laser drilling there is now consensus – a wide range of industry association’s advocate this change to the FTC Guides.

This petition seeks to address concerns that the FTC may have regarding making this revision. It also presents new information, which was not been available in 1996. Of course, if there are any questions that develop from this presentation, the JVC stands ready to address those matters.

Summary of Petition Points

The following Petition advocates revising the FTC Guides for the Jewelry, Precious Metals and Pewter Industries to include a requirement to disclose laser drilling of diamonds. Since 1996, when this topic was first raised, industry consensus has built in favor of this revision of the Guides. Today, all major trade associations endorse this revision, especially in light of the importance that the industry assigns to the Guides. Further, since it is now the policy of the industry to make this disclosure at all levels of the transaction up to the level of the consumer, there is no compelling reason to exclude the consumer from this disclosure.

Certain assumptions made in 1996 by the industry and the FTC in making its decision not to require this disclosure cannot be fully supported in light of new information and developing technology. Lasering technology has improved, making it increasingly difficult for the consumer to detect the process, especially when diamonds are mounted in jewelry. The assumption

that most diamonds are bought with a grading report is not supported by the evidence. Moreover, lasering has an effect on the value of the diamond, thereby requiring disclosure in order to prevent consumer deception and to insure that consumers pay a fair price. There is even some anticipation in the industry that requiring this disclosure will open a new market segment.

Today's consumer wants this information, and feels tricked when it is discovered after the sale, even though the process improved the diamond. Additionally, there are no additional costs which will be passed on to the consumer from this disclosure, in light of the new industry policy of making the disclosure in writing at all levels.

The FTC owns standards for disclosure contained in the Guides may require this disclosure. In other provisions of the Guides, man-made, non-natural procedures must be disclosed to protect the consumer from deception about the nature of the item they are purchasing and to insure a fair price. The same standard should be applied here.

Argument

1. The Market for Diamond Jewelry and The Use of the FTC Guides by the Jewelry Industry

The jewelry industry in the United States is highly complex and represents a significant portion of the manufacturing and retail sector of the United States economy. The diamond jewelry portion of the industry alone represents enormous financial power - in 1997, the total retail market for the acquisition of diamond jewelry (any jewelry piece that includes at least one real new diamond, no matter how small) was measured at nearly \$25 billion.¹

The manufacturing and retail segments of the jewelry industry are acutely aware of

¹Diamond Promotion Service, 1997 Redbook - The Market for Diamond Jewelry.

the regulatory requirements applicable their business, and look to the FTC Guides as the premier document to provide standards to which they must comply. It is interesting to note that although there is a widespread mistaken belief in the industry that the Guides lack any level of legal authority, they are universally cited as the "Bible" for all segments of the industry. Many jewelers keep the Guides handy at their retail and manufacturing establishments for easy reference. Industry educational institutions (such as the Gemological Institute of America) and trade associations (such as Jewelers of America) offer training as to the contents of the Guides, and refer to them, often to the exclusion of other legal regulatory requirements provided elsewhere, as the legal standards which must be met in the industry. Thus, the role of the FTC Guides is central to legal compliance in the jewelry industry.

2. Consensus for Including this Requirement in the FTC Guides has Built

At the time that the Guides were revised in 1996, there was strong opposition to including mandated disclosure of laser drilling from some diamond associations. As of the declaration at the July 1998 World Diamond Congress, that opposition has ended. The industry now strongly and with one voice advocates this revision and has already agreed to mandate this disclosure.

At the meeting of the World Diamond Congress in Bangkok in July 1998, the World Federation of Diamond Bourses and the International Diamond Manufacturers Association reversed their previous positions and issued the following policy statement:

"Although laser drilling is an acceptable permanent process utilized in the cutting and polishing of diamonds, and does not infuse a foreign substance into a diamond or otherwise affect its integrity, it is nevertheless required that this process be disclosed in writing when diamonds are offered for sale.

This resolution shall go into effect as of January 1, 1999."²

Thus, it is clear that previous opposition to this disclosure has changed, and consensus has built. This consensus arises from the evolution of the use of lasering technology, a re-examination of some of the basic assumptions relied upon by the FTC and others in 1996, and changing market conditions. These changing market conditions include increased consumer sensitivity to full disclosure of the true nature of the merchandise they are purchasing and a developing market segment which could see an increased consumer demand for diamonds which have been lasered and may represent a more economical way to purchase a higher clarity grade diamond. By mandating disclosure, the industry seeks to strengthen its credibility by acknowledging that consumers have been educated to the point that full disclosure is the proper course.

Therefore, given the industry's consensus on this issue, for reasons of consistency and in order to maintain the integrity of the FTC Guides, it is important that the Guides include this requirement. The Guides are the touchstone document in the industry - they should be consistent with the disclosure practices in the industry.

3. Improvements in the Technology of Laser Drilling Reduces the Ability to Detect the Process

Laser drilling has been in use as a means by which to improve clarity for diamonds since the late 1960's. This process entails making a tunnel (or pathway) from the targeted inclusion out to the surface of the diamond using a laser beam, then employing an electrical "sparking" process, which cleans and finishes the pathway. Once the tunnel is complete, the diamond is subject to prolonged exposure to a bleaching agent under intense heat thereby removing the black inclusion.

²Statement of World Federation of Diamond Bourses and International Diamond Manufacturers Association, July 1998.

The manner in which the laser is utilized in the drilling process has, not surprisingly, improved since the late 60's. Continuous wave lasers have replaced pulse lasers, producing a cleaner, smoother, shorter and thinner drill hole and tube.³ However, the goal of laser drilling has remained the same - improving the clarity of a diamond by removing the black inclusion.

According to trained gemologists working at the laboratories of the Gemological Institute of America, there has been improvement in the use of this technology.⁴ Narrower drill holes are now created in order to accomplish the goal of the drilling process, and the increased proficiency of operators of the laser has resulted in diamonds, which indicate fewer attempts to eliminate the inclusion. GIA experts also have detected less evidence of burning or cratering by the laser beam at the hole entrance on the surface of the diamond. Moreover, the lasering of smaller diamonds has become more prevalent, resulting in higher clarity grades for smaller diamonds.

Given the improved technology, the ability of a consumer acting reasonably using only 10X magnification to detect this process has been severely reduced. As demonstrated below, it is no longer safe to assume that a consumer would be on notice of laser treatment by simply looking.

4. Laser Drilling Improves Clarity Grading

Removing the black inclusion through the lasering process improves the clarity grading of the diamond. At the same time, the introduction of the drill hole does not necessarily negatively impact the clarity of the diamond. According to the GIA, the existence of the tunnel

³Roskin, G., "Laser Drilling -Another Time Bomb?," Jewelers Circular Keystone, March 1998, at 86.

⁴Shigley, J.; Schwartz, E., Gemological Institute of America.

alone almost never downgrades the clarity designation assigned to a diamond. Indeed, the laser drilling process when successful always improves the clarity. The tunnel is less severe a flaw than the inclusion that has been eliminated.⁵

According to the experts at the GIA, most diamonds that have traditionally been subject to laser drilling are from the S1 through I3 range, thereby increasing their clarity grades by one or two levels through this process. GIA has also seen examples of VS1 and VS2 diamonds with laser drill tunnels.

A drill hole is invisible to the naked eye, and often cannot be detected, unless by a professional, even under 10X magnification either because the tunnel is too small to be detected under this level of magnification or because it is hidden by other flaws, including other inclusions which may not have not been laser drilled. Moreover, the tunnels are extremely difficult to detect when the diamond is mounted in a jewelry setting. Certainly, an untrained observer using only 10X magnification would be unlikely to find a laser drill tunnel without substantial guidance by a jewelry professional.

5. Laser Drilling Improves the Value of the Diamond

According to some diamond experts, the price differential between a diamond which has a natural black inclusion and one which has had the inclusion removed by laser drilling could

⁵Another problem exists when describing any invasive process to improve clarity of the diamond as simply "clarity enhanced" without more. This phrase should always be followed by a specific description as to which exact process has been used to improve the clarity of the diamond, i.e. "clarity enhanced by lasering."

be as much as 25%.⁶ As already demonstrated, by removing the black inclusion, the laser drilling improves the diamond's clarity, hence improves the value of the diamond when compared with a non-drilled diamond with the natural inclusion. As long as laser drilling is disclosed, the "saleability" of the diamond is improved in that it renders the diamond more attractive to the consumer at a particular price point. When compared to a diamond without black inclusions, the laser-drilled diamond is of a lower value. Customers, if offered two diamonds of "identical" appearance - one lasered and the other not - will probably prefer the unlasered diamond or expect a price difference, with the lasered one costing less. However, there is concern in the industry is that undisclosed laser drilled diamonds improves the diamond's clarity, hence improves the value of the diamond when compared with a non-drilled diamond with the natural inclusion. As long as laser drilling is disclosed, the "saleability" of the diamond is improved in that it renders the diamond more attractive to the consumer at a particular price point.

"Laser drilled holes are often so narrow, short and non-reflective that they can be missed under a loupe, but they make a stone worth less than its non-lasered counterpart."⁷ However, when customers learn that such diamonds can cost less but are graded for clarity as high when compared to a diamond without an inclusion, disclosure of laser drilling becomes a selling point. This could open to a larger market segment the opportunity for purchasing diamonds with a high

⁶Bates, R. "Special Report - Laser Ills", New York Diamonds, September 1998, at 52, 54, quoting, among others, Martin Rappaport.

⁷Federman, D. "About Face", Modern Jeweler, October 1998, at 118. The Author goes on to state: "This means disclosure is needed, but it doesn't mean apology is."

tech improvement: a man-made inclusion (laser tunnel) invisible to the eye, which substantially improves the clarity and appearance of the diamond.

6. Consumers Want this Disclosure

When it comes to purchasing diamond jewelry, today's consumer is more knowledgeable than ever. Sophisticated buyers are increasingly aware of the questions they should ask, the need for comparison shopping, and the necessity of buying from a reputable, professional jeweler who is committed to making necessary disclosures to insure customer confidence that they are getting the right goods for the right price. Because this often promotes repeat business, and the establishment of a reputation in the community for sound business practices, many jewelers have approached disclosure as a positive marketing tool. Mandating disclosure compels all jewelers to make this disclosure thereby leveling the playing field and insuring that the consumer is aware of the true nature of the purchase.

In July 1996, the FTC explained its decision not to include this disclosure in a letter to the JVC, pointing to conclusions about consumer awareness and lack of actual harm to consumers from the failure to disclose laser drilling.⁸ In that letter, assumptions were also made about the ability of a consumer to detect laser drilling. As demonstrated, those assumptions may not be fully correct.

It should be noted that the vast majority of diamonds are bought in sizes averaging

⁸ See, Bernstein, J., Letter from the Office of the Director, Bureau of Consumer Protection, Federal Trade Commission to the Jewelers Vigilance Committee, July 29, 1996.

no more than .35 to .75 carats and without grading reports.⁹ While we can take it as a given that most diamonds are not flawless and most consumers should be aware of that fact, the ability to identify the nature of those flaws without the guidance of a professional should not be assumed. Thus, past assumptions about consumer expectations regarding surface imperfections in diamonds (that is, that consumers do not expect diamonds to be flawless) combined with the inability of an unguided consumer to see the man made laser tunnel using 10X magnification, and the fact that diamonds are more often than not purchased without a grading report (thereby obviating the need for disclosure) can be supported. Since this process leaves a tunnel that is man made and not natural, it should be disclosed despite the fact that it may be similar to other natural surface imperfections.

In its letter to the JVC in 1996, the FTC also expressed views regarding the lack of consumer injury arising from failure to make this disclosure. Recent history, however, indicates that the consumer, if not informed of this man made clarity treatment, essentially feels duped - the diamond has been altered (albeit improved) and the consumer was not informed. There are a notorious examples, much covered in the trade press, of consumers insisting on returning diamond jewelry because this process was not disclosed, in spite of the fact that the process improved the clarity of their diamond.¹⁰

In its letter, the FTC expressed the view that the injury of non-disclosure could easily

⁹ Ehrenwald, J.; International Gemological Institute; Shigley, J.; Gemological Institute of America.

¹⁰ See, Parker, D., "Laser Drilling Sparks Consumer Crusade", Rappaport Diamond Report, April 3, 1998 at 23; Shor, R., "TV Reporter Airs Report on Lasered & Filled Diamonds", New York Diamonds, January 1998, at 24.

be avoided by examination of the diamond and a grading report. As has already been demonstrated, because of technological advances, the laser tunnels are increasingly difficult to detect, and the vast majority of diamonds are purchased without a grading report. Thus, the injury is not easy to avoid.

The FTC went on to state that even assuming arguendo, that a consumer were to purchase a diamond without a grading report and without magnified examination of the diamond, "the record indicates that the injury would likely be offset by benefits to competition and consumers...[D]isclosing laser treatments would be costly...and could inhibit advertising...and additional costs would be passed on to consumers."¹¹ Since the diamond industry already intends to make these disclosures in writing within the trade commencing on January 1, 1999, it is hard to imagine that the requirement to disclose would increase costs to the consumer. All levels of transactions before the point of sale to the consumer would include the disclosure - adding it at the consumer level would not present a severe additional burden. This would simply be an additional mandated disclosure. In fact, as already stated, there is anticipation that this disclosure could reap real benefits to the consumer, opening a market segment for laser drilled diamonds allowing for the purchase of higher clarity grade diamonds at a more economical price.

7. FTC's Standards May Require this Disclosure

The FTC Guides require disclosure of procedures which are the result of human intervention because the procedure may result in properties that are not permanent or because the product may require special care or may change over time. FTC Guides, §§23.13, 23.22. However, other provisions of the Guides require procedures to be disclosed which result in permanent

¹¹ Bernstein, J., *Supra*.

properties simply because they are the result of human intervention. The basis for that disclosure is that the consumer should be put on notice of artificial, man-made and non-natural procedures which produce certain properties or characteristics which may impact the price paid for that item.

For example, according to the FTC Guides, a natural pearl produced without any human intervention can be described as a "pearl," without any qualifying designation. FTC Guides, §23.18(a). However, a pearl which has been produced by an act of human intervention: planting a nucleus inside the shell, must disclose that process by utilizing the term "cultured" when describing the resulting product as a pearl. FTC Guides, §§23.18(b), 23.19(b). This assures the consumer is not deceived about the nature or quality of the pearl they are purchasing, and that they are paying a fair price for that item. The same assurance should be applicable to the consumer when buying a diamond which has an artificial, man-made, non-natural process, applied to it. Disclosure in this context insures that they are not deceived about the nature or quality of the diamond they are purchasing and that they are paying a fair price. In §23.24, the FTC Guides proscribe the use of the words "real," "genuine," "natural," "precious," etc. to any industry product which is manufactured or produced artificially. Again, the underlying concern is for deception - failure to disclose that an artificial, human intervening process has been used to create an industry product could result in a consumer being misled about the quality or nature of the product that is being purchased. Similarly, the artificial process of laser drilling a diamond to remove a black inclusion thereby producing a better appearance of clarity should be disclosed. This insures that the consumer is fully on notice of all of the properties of this diamond and understands why there is a price differential.

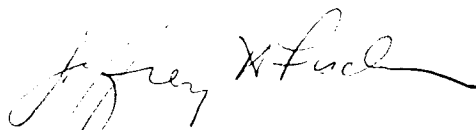
The FTC Guides seem, therefore, to have two bases for requiring disclosure: first, any process (treatment) which could require special care or change over time should be disclosed;

and second, any process which is artificial, the result of human intervention and non-natural should be disclosed. Laser tunnel is permanent, but it is surely the result of a non-natural process and human intervention. On that basis alone it should be disclosed to avoid deception and unfair pricing.

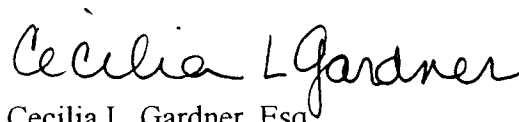
Conclusion

Since, according to its own policies, the process of identifying and disclosing laser drilling by the trade will already have been done at all levels of the transaction up to but excluding the consumer, it seems logical that this disclosure should also be made to the ultimate purchaser - the consumer. The consumer today demands to be on notice of all the relevant properties, which exist in the item, being purchased. Thus, requiring this disclosure is consistent with sophisticated consumer expectations and the industry's desire in today's market to achieve credibility and honesty in jewelry transactions. Given the industry's faith and reliance on the FTC Guidelines, this disclosure should be incorporated as consistent with industry practice and for the good of the consumer.

Respectfully submitted,



Jeffrey H. Fischer, President
DMIA



Cecilia L. Gardner, Esq.
Jewelers Vigilance Committee
Executive Director and General Counsel