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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Policies and Rules	)	CC Docket No. 93-292
Concerning Toll Fraud	)	

COMMENTS OF
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee (Ad Hoc Committee) hereby submits its initial comments in response to the Notice of Proposed Rulemaking (NPRM), released in the above-captioned docket on December 2, 1993.

This proceeding is very timely, if not overdue. The Commission's assessment that toll fraud has become a major problem is correct. Many corporate telecommunications users, for example, have learned the hard way how vulnerable their PBXes are to fraudulent misuse. And as the NPRM reflects, the victims of PBX-related fraud are not alone in their losses, since the perpetrators of fraud have found a number of other methods for plying their trade.

Thus, it is important that the Commission adopt rules and policies for allocating clearly and fairly the losses associated with fraud. The underlying principle should be that liability for toll fraud should be allocated in each instance to the party who can most readily and economically take steps to detect and prevent the fraud.

The Ad Hoc Committee will review and, as appropriate, respond to the initial comments of other

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parties. At this time, the Ad Hoc Committee's comments are limited to two areas. First, any losses resulting from perpetrators' manipulation of the network that are not attributable to customer equipment should fall in the ordinary course on the carrier, not the customer. Second, while it is appropriate for the Commission to require carriers and CPE vendors to warn their customers of the hazards of toll fraud, the Commission should be careful to frame the warning requirement in a way that does not inadvertently deprive customers of their right to pursue remedies against carriers and vendors for their losses under such causes of action as negligence, fraud, intentional or negligent misrepresentation, breach of contract or breach of warranty.

1. Losses From Network-Based Fraud Should Ordinarily Fall On The Carrier.

At the outset, it should be stressed that the categories of toll fraud outlined by the Commission are not exhaustive. They do not include network-based fraud. There exist today various network-based services that allow a user to dial an 800 number, enter an access or authorization code, and then make an outgoing call.[1/] To the legitimate caller, this functionality is equivalent to that of PBXes with a remote access feature enabled; there too the caller dials an 800 number, enters an access code, and is able to

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1/ One among many examples of such services is AT&T's Type I Authorization Codes in Tariff 12.

make outbound calls. And as is the case with PBX fraud, such services can be "hacked" by an interloper with adequate cleverness and patience. The difference is that when the remote access service is network-based, no PBX or other customer premises equipment is involved. The switching between the inbound call and the outbound call and -- most importantly -- the verification of the access or authorization code are done entirely within the network. Moreover, only the carrier is in a position to monitor the use of network-based services to detect suspicious patterns of usage and, ultimately, to disable the code or number to prevent fraud.

Because it is the carrier, not the customer, that has the ultimate power to take steps to detect and thwart fraud using network-based remote access services, losses arising from such fraud should be allocated to the carrier rather than the customer, and the Commission should adopt a policy that any tariff provision or other attempt by the carrier to force the customer to bear such losses is unjust and unreasonable.[2/] Only if the carrier can show that the

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2/ This is not to suggest that the carrier should in all cases unilaterally shut down numbers upon even the slightest suspicion that something is amiss. For some customers, the need for their personnel to have advance notice of the disabling of their calling capabilities may cause them to demand that the carrier consult with them prior to disabling a number or code; such customers might in some instances agree to assume some risk of loss in exchange for not having a number or code disabled. In such instances, carriers and their

(continued...)

proximate cause of the loss was the negligence or willful misconduct of the customer -- and that the carrier did not have the "last clear chance" to avoid or prevent the loss, such as by using reasonable network monitoring techniques[3/] -- should the loss fall on the customer.

2. In Adopting Warning Requirements, The Commission Should Leave Undisturbed Customers' Rights To Recover Damages Under State Law From The Vendors Of Goods And Services.

The Commission seeks comments regarding appropriate preventive measures for fraudulent outbound calls made by remote access through a customer's PBX. The need for such preventive measures has been dramatically documented by recent cases brought before the Commission involving hundreds of thousands of dollars in toll fraud, with customers and carriers in heated opposition as to liability for costs incurred.[4/] In addition, commenters to a parallel proceeding to this NPRM testified to costly examples of toll fraud and suggested that with the introduction of new technologies, the occurrence and

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2/ (...continued)
customers can negotiate a consultation process. But this negotiation can only work if, as a default, the carrier is liable for network-based fraud.

3/ See generally W.P. Keeton, et al., Prosser and Keeton on The Law of Torts 462 et seq. (5th ed. 1984).

4/ Chartways Technologies, Inc. v. AT&T Communications, Memorandum Opinion and Order, FCC 93-394 (released August 19, 1993); United Artists Payphone Corp. v. New York Telephone Co. and AT&T, Memorandum Opinion and Order, FCC 93-387 (released August 18, 1993).

opportunities for such misuse of remote-access equipment will be increased significantly.[5/] The Commission therefore tentatively concluded in this proceeding that, among other provisions, carriers and equipment vendors must have an affirmative duty to effectively warn customers of the potential exposure to fraud.

The Ad Hoc Committee applauds the Commission's efforts to address this costly and growing area of criminal activity and generally supports the Commission's intention to require equipment vendors to provide specific warnings to customers of potential exposure to fraud. Warning labels in the equipment documentation and packaging that will alert a customer to potential misuse of PBX equipment, and therefore assist the customer in employing preventive technology and programming, could be mutually advantageous to both the customer and the vendor. Such a warning might also inhibit an overzealous sales representative from inflating the security features of a piece of equipment in order to earn a commission.[6/] It is somewhat questionable, however, that

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5/ Pacific Mutual Life Insurance filed a petition requesting that the Commission declare unlawful AT&T's holding the petitioner liable for payment of costs incurred as a result of toll fraud. One commenter on that petition, Perkin-Elmer Corporation, alleged that it incurred a cost of $250,000 in tolls. NPRM, paragraphs 16 and 17.

6/ See NPRM, paragraph 15. Perkin-Elmer Corporation stated in its comments to the petition filed by Pacific Mutual Life Insurance that it had relied on AT&T's alleged misrepresentations regarding the PBX equipment.

merely including the warning in equipment manuals and packaging, as the Commission's proposed rule Section 68.200(1) appears to contemplate, would prevent such over-selling altogether, since many customers do not read the equipment manual or packaging in detail until after the purchase is made. To be more certain of the warning's efficacy in this regard, the Commission should consider requiring that it also be included in any bill of sale, purchase or lease contract for the equipment.

There is, however, an even more fundamental issue raised by the Commission's proposal. Using precedents established in cases of cigarette and insecticide warning labels, a vendor might successfully argue that its compliance with the Commission's warning requirements preempts the customer from pursuing common law remedies otherwise available.

In the ordinary commercial world, if a customer buys a product in reliance on certain assurances from the vendor, and if those assurances turn out to be false with loss to the customer resulting, and if that loss was foreseeable at the time of the sale, the customer may sue the vendor for damages under such theories as fraud, negligent or intentional misrepresentation, breach of contract or warranty or ordinary negligence. If the customer can prove all the requisite elements of its cause of action, and if the vendor cannot make out an affirmative

defense, then the vendor must pay damages to the customer. These causes of action and defenses are usually matters of state statutory and/or common law.

Consider, then, the following scenario: a customer buys a PBX, relying on vendor statements regarding its security features. These statements turn out to be false or the security features malfunction, allowing the PBX to be hacked. As a result, the customer is billed thousands of dollars by its carrier for outbound calls made by the hacker. In the ordinary course, the customer would be able sue the PBX vendor for damages in state court. If the customer is successful, then an element of the customer's damages would be reimbursement by the CPE vendor of the toll charges the customer has incurred as a result of the fraud. The availability of this set of remedies is not only fair and equitable to the customer; it serves as a disincentive for vendors to make misrepresentations about their products, and motivates them to take responsibility for their products' operating as stated.

Unfortunately, unless the Commission is careful, these remedies may be lost to consumers. In several cases, courts have been faced with having to decide whether federal regulations requiring warning labels for products or equipment expressly or impliedly preempt state common law remedies in tort. In Cipollone v. Liggett Group, Inc., ___ U.S. ___, 112 S. Ct. 2608 (1992), for example, a plurality

of the Supreme Court construed the federal statute requiring warning labels on cigarette packages as impliedly preempting at least some state tort claims in which the cause of action was predicated on failure to warn or fraudulent misrepresentation. 112 S.Ct. at 2620-22, 2623-24.

Following Cipollone, the Nevada Supreme Court held in Davidson v. Velsicol Chemical Corporation, 834 P.2d 931 (Nev. 1992), that a federal statute requiring warning labels on pesticides impliedly preempted various state tort actions against the manufacturer. The Nevada court determined that state common law was preempted because the federal regulation was sufficiently comprehensive to "occupy the entire field" of the issue (834 P.2d at 936), and because a jury verdict for the plaintiff might contradict the labeling provisions of the federal statute.

The cases cited here demonstrate vividly the difficulty courts face, in the absence of clear statutory or regulatory language, in determining to what extent federal warning label requirements preempt state tort claims. This is a hotly contested and highly uncertain area of the law, and there exists no bright line for determining how or when courts will apply implied preemption theories. In light of this uncertainty, the Ad Hoc Committee urges the Commission to take steps to assure that any regulations it adopts requiring specified warnings will not be deemed to preempt customers' remedies against vendors under state laws.

The easiest means of doing this is suggested in Cipollone itself. Although Cipollone held that the federal warning label requirements preempted some of the petitioner's state claims, the Court acknowledged that "there is no general, inherent conflict between federal preemption of state warning requirements and the continued vitality of state common law damages." 112 S. Ct. at 2618. As an example of an instance in which state law claims would clearly survive federal warning label requirements, the Court cited federal regulations which required a warning label on smokeless tobacco products, preempted state interference in the substantive provisions of the warning label regulation, yet expressly preserved state law damage actions arising out of use of those products. The cited provision appears in Section 4406 of the Comprehensive Smokeless Tobacco Health Education Act, 15 U.S.C. § 4406, subsection (c) of which states: "Nothing in this chapter shall relieve any person from liability at common law or under State statutory law to any other person."

The Ad Hoc Committee urges the Commission to include parallel language in its proposed Section 68.200(1) of the Rules, setting regulatory requirements for warning labels on PBX equipment. Failing to do so will needlessly place in doubt the ability of a victim of toll fraud to pursue its legitimate right to damages in state court.

3. Conclusion.

Though it is headed in the right direction, the NPRM fails adequately to address fraud using network-based remote access and does not sufficiently protect the rights of users of PBXes to pursue legal remedies against their vendors. Any rules adopted by the Commission should rectify both of these omissions.

Respectfully submitted,

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January 14, 1994

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