

**PREPARED STATEMENT
OF THE FEDERAL TRADE COMMISSION
ON OFFICE SUPPLY FRAUD**

**Before the
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE**

Washington, D.C.

March 28, 2000

I. Introduction

Mr. Chairman, I am Jodie Bernstein, Director of the Bureau of Consumer Protection at the Federal Trade Commission.¹ I am pleased to be here today to testify about office supply fraud. I want to thank the Committee for holding this hearing and drawing public attention to these scams. Such scams cost victims of office supply fraud, typically small businesses and non-profit organizations, an estimated \$200 million a year.²

Office supply scams have been around for at least 20 years³ and show little signs of abating despite aggressive and continuous law enforcement efforts by the FTC and other federal and state agencies. In just the last nine years, the FTC has brought 25 office supply fraud cases. One of the most common forms of office supply fraud occurs when businesses receive bills for merchandise that they never ordered, shipments that were never authorized, or bills for products that were never received. These scams succeed because the bills the scammers send look just like the legitimate invoices that arrive at a small business every day, and the products they

¹ The views expressed in this statement represent the views of the Commission. My responses to any questions you may have are my own.

² Imaging Supplies Coalition. The ISC is a non-profit trade association; its members are 10 major manufacturers of consumable imaging supplies. The ISC combats counterfeiting, telemarketing fraud and other illegal activities that affect its members and their members' customers. A 1999 ISC survey estimates that telemarketing fraud causes \$125 million in losses to imaging supply manufacturers annually, which, when adjusted for dealer mark-up, results in higher losses for the end-users. The ISC data underestimate the total amount of fraud because figures are not available for other office and cleaning supply industries.

³ The Business Technology Association reports that it began to assist law enforcement efforts against toner fraud in the late 1970s. The BTA is an international organization with 3100 members who are primarily independent dealers of office supplies and business equipment.

receive are ones they regularly order. And, the incredible growth in the number of small businesses in the past few years provides a steady supply of potential new victims.⁴

I am pleased to announce today recent law enforcement successes in this area and the launch of an extensive, grass-roots based business education campaign called **Project BOSS** (Banish Office Supply Scams). Through new and expanded partnerships, Project BOSS will reach companies at inception and provide existing organizations with new educational tools to assist them in detecting and avoiding office supply scams.

II. Background

The FTC is the federal government's primary consumer protection agency. Congress has directed the FTC, under the Federal Trade Commission Act,⁵ to take action against "unfair or deceptive acts or practices" in almost all sectors of our economy and to promote vigorous competition in the marketplace. The FTC Act authorizes the Commission to halt deception through administrative cease and desist actions and equitable actions filed by FTC attorneys in federal district court.⁶ Typically these civil actions seek preliminary and permanent injunctions to halt the targeted illegal activity, as well as redress for victims. Where redress is impracticable, the Commission obtains disgorgement to the U.S. Treasury of defendants' ill-gotten gains or, in certain situations, uses the money to conduct educational campaigns to prevent further fraud.

⁴ According to the U.S. Small Business Administration, new business formation reached a record level in 1998 (the most recent year for which statistics are available), up 1.5% from 1997, with an estimated 898,000 new companies opening their doors.

⁵ The Commission also has responsibilities under more than 40 additional statutes.

⁶ 15 U.S.C. §§ 45(a) and 53(b).

The Commission attacks office supply fraud in several ways. Because almost all fraudulent office suppliers use the telephone, the Commission typically alleges violations of the Telemarketing Sales Rule. The Rule defines and prohibits deceptive telemarketing practices and allows the Commission (and the states) to seek injunctive relief, redress and/or civil penalties for Rule violations.⁷ In prosecuting office supply scams, the Commission also uses its broad authority under Section 5 of the FTC Act, which prohibits unfair or deceptive practices, to charge that scammers misrepresented their identities, the purpose of their calls and the goods and services they sold.⁸ The Commission typically prosecutes office supply fraud cases as civil actions in federal court, and seeks ex parte temporary relief such as asset freezes (to ensure that money will be available for victims when the proceeding is over), and permanent injunctive relief, such as bans on telemarketing, and redress or disgorgement.

III. Office Supply Frauds

Office supply scams involve the deceptive sale of non-durable, or consumable, products that are used in the course of business and purchased on a regular basis. The fraud is committed through misrepresentations over the telephone and by direct mail. By far, the most prevalent

⁷ 16 C.F.R. Part 310. The Telemarketing Sales Rule does not generally apply to business-to-business sales calls. The Commission's enforcement experience with office supply scams, however, led it to create an exception in the Rule for telephone calls "involving the retail sale of non-durable office or cleaning supplies." 16 C.F.R. § 310.6(g).

⁸ On occasion, the Commission also may allege violations of the "Unordered Merchandise Statute," 39 U.S.C. § 3009 of the Postal Reorganization Act, which prohibits mailing unordered merchandise and billing for it and makes such conduct a violation of Section 5 of the FTC Act.

product pitched by fraudulent office suppliers is copier machine or printer toner, and is known throughout the industry and law enforcement as “toner-phoner fraud.”⁹

A. How the Fraud Works

No matter the product, office supply scams generally operate the same way. Most fraudulent office supply companies use generic, common names, such as “Central Supplies,” “Industrial Chemical, Inc.,” “United Wholesalers,” and “Regional Copier Supply” to avoid standing out.¹⁰ Operating out of boilerrooms furnished with dozens of desks and telephones, telemarketers arm themselves with lists of businesses and non-profit groups and their telephone numbers (e.g., all the car dealerships or churches in one area). Then, the telemarketers call.¹¹ Sometimes they try to obtain the name of an employee, or the brand or serial number of the copier the office uses under the guise that they are verifying existing records. They make the recipients feel as if they are dealing with their regular supplier. At other times, the caller merely asks the employee if the business wants to receive a free gift or sample. Either way, through false pretenses the caller seemingly obtains someone’s consent to ship office supplies or makes it appear as if consent had been given.

Some time after that easily forgotten telephone call, toner cartridges or cleaning supplies or light bulbs arrive. They are likely to be overpriced and not the brand, quantity, quality, size or

⁹ Other products, such as light bulbs and maintenance supplies, are also “consumables.”

¹⁰ These are names of some of the companies the Commission has sued.

¹¹ In some Commission cases, consumers report that they did not get a phone call but received unordered merchandise and a bill, nonetheless. This scenario is more common to unordered services, rather than unordered merchandise, schemes. For example, in *FTC v. AKOA, Inc.*, 97-7084 (C.D. Cal. 1997), organizations received bills, but no phone call, for unordered computer maintenance contracts. Some victims, such as churches, didn’t even own a computer.

type that the office usually orders.¹² A short while later, armed with information they obtained during their calls (e.g., an employee's name, the copier brand), telemarketers send invoices that make it appear that they are the business' regular supplier. The invoices typically range from a couple hundred dollars up to \$1,000. Based on our recent law enforcement experiences, the initial invoice scammers send averages \$550 for toner and \$160 for cleaning or maintenance supplies. If the initial bill is paid, the business continues to receive more unordered and unwanted supplies and ever higher bills for them.

B. Why Office Supply Scams Work

Office supply scams succeed for several reasons. First, the scam invoices appear to be legitimate and can easily blend in with other invoices an organization receives. Second, the organization may not have a well-established protocol for purchasing goods, or employees or volunteers at small organizations may be handling bill payment duties sporadically or for short lengths of time. Thus, they may only have limited knowledge about who are the regular vendors and suppliers and how much office supplies should cost. Third, the person who receives the goods and the person who receives the invoice often are different people so the high price charged for the inferior goods may not get noticed. Fourth, even if an employee realizes that the business has been tricked, the employee may feel that he or she consented to the order or started using the supplies before realizing that the business has been scammed. Thus, the employee

¹² For example, in *FTC v. Commercial Electrical Supply, Inc.*, 96-1982 (D.Md. 1996), a church in Arizona received 120 unordered light bulbs costing more than \$3 each. An associate pastor stated that the church would never buy that many light bulbs from a company in Maryland when they could be bought for .55 cents each locally, without any shipping costs. Similarly, a Jewish Community Center in Florida received 120 unordered incandescent light bulbs; it didn't even have any fixtures that used such bulbs.

believes that the company is obliged to pay. Fifth, if an employee becomes aware of the scam, he or she may try to get the sender to cancel the invoice and accept return of the product. In those instances, the scammer typically tries to persuade the caller to keep the goods for a “lower price,”¹³ refuses to accept the returned merchandise, or charges a substantial “restocking fee” before accepting return of the unordered merchandise. If the business pays to return the product, agrees to pay “restocking fees,” or is convinced to pay a lower price, the scam has succeeded because the fraudulent company has made a profit or has the product back so that it can be shipped to another victim. Above all, the fraudulent companies purposefully create confusion over the invoice or goods and exploit the fact that often new or inexperienced personnel may be handling these matters.

The problem doesn’t stop with the phony invoice. Despite listing toll-free “customer service numbers” on their invoices, fraudulent office supply telemarketers give consumers the run-around, harass them into paying, question their honesty, and almost never give refunds. Complaint letters go unanswered, and many victims give up.¹⁴ For many businesses, and even some non-profit organizations, the hassle of dealing with these fraudulent companies is not worth the effort. In those situations, the telemarketers have won.

¹³ In reality, this “lower price” is still much higher than the company’s true supplier’s price for the amount shipped.

¹⁴ Often a company issues a refund if a complaint is filed with the Better Business Bureau or a state Attorney General’s office to ward off attention from law enforcement authorities.

C. The Extent of the Problem

Understandably, it is difficult to quantify the extent of the office supply fraud problem. From 1995 through 1999, the Commission logged in nearly 4,000 complaints regarding toner-phoner fraud and nearly 1,000 complaints about other types of office supply fraud.¹⁵ As with other frauds, these numbers undoubtedly underestimate the number of victims. In one Commission case where we were able to determine the number of victims, we found that a medium-sized fraudulent toner operation victimized 23,000 small businesses and non-profit organizations in a four-year period.¹⁶

The complaints and our prior law enforcement actions indicate, however, that there are many office supply boilerrooms doing business on a relatively small scale compared to other frauds. For example, in Operation Misprint, our most recent law enforcement initiative, the 1999 annual gross sales of the twelve targeted companies totaled approximately \$34 million. The average annual gross sales per company, therefore, were about \$2.8 million. At the extremes, however, the twelve companies had annual sales ranging from \$200,000 to \$11 million. These numbers and the fact that we receive complaints about dozens of companies (usually only a few for each one) strongly suggest that there are many small boilerrooms that understandably do not

¹⁵ These figures are from Consumer Sentinel, the first Internet-based, binational computerized consumer fraud database in North America. Consumer Sentinel receives complaints from consumers via email, telephone calls and letters that are processed through the FTC's Consumer Response Center. Other public and private consumer organizations, including Better Business Bureau offices, the National Fraud Information Center and Project Phonebusters in Canada, also submit data to Consumer Sentinel. In addition, companies such as Xerox, which receives many complaints about toner-phoner fraud, contribute complaints to Consumer Sentinel.

¹⁶ *FTC v. Michael Chierico*, 96-6671 (S.D. Fla.).

always attract law enforcement attention, but nonetheless cause significant financial harm and annoyance to thousands of small businesses and other organizations.

D. The Growth of Small Businesses

Office supply fraud persists in part because the pool of potential victims grows larger every year. There are about 24 million small businesses in the United States, representing 99% of all U.S. businesses. This past decade has seen a great increase in the rate of new business formation with small businesses providing virtually all of the nearly 20 million new jobs added to the economy since 1992.¹⁷ Most small businesses have copiers and printers and need maintenance and cleaning supplies, so all are potential victims of unscrupulous telemarketers.

Individual stores and franchisees, even though they may be part of very large corporations, also are susceptible to office supply fraud. Likewise, charitable organizations, places of worship, government offices, college sororities and fraternities, even congressional offices, are victimized.

IV. The FTC's Law Enforcement Response

The Commission has a tradition of tackling all types of fraud regardless of whether the victims are individuals or small businesses.¹⁸ In fact, some of the earliest hard-core fraud cases brought by the Commission in federal courts in the mid-1980s were toner-phoner frauds. Since

¹⁷ The Small Business Administration's Advocacy Office provided data on small businesses.

¹⁸ Besides office supply fraud, small businesses also are the targets of other fraudulent schemes. For example, on October 25, 1999, Bureau of Consumer Protection Director Jodie Bernstein addressed this Committee about Web Site Cramming, the practice of causing unauthorized charges for Web site services to appear on small businesses' telephone bills. The Commission also has prosecuted unordered advertising in illegitimate phone directories ("Yellow Pages" scam), and fund-raising on behalf of nonexistent charitable or civic groups.

1986, the Commission has prosecuted 28 office supply fraud lawsuits involving nearly 60 corporations and 60 individual defendants.¹⁹

Many of the Commission's office supply fraud cases were brought as part of law enforcement "sweeps." A sweep is a coordinated, multi-agency effort to target a particular type of fraud nationwide or frauds located in a particular geographic area.²⁰ Sweeps involve the filing of many cases at the same time by federal, state and local government authorities and the launching of consumer and business education campaigns aimed at preventing future losses. The Commission brought its first sweep involving office supply fraud, called "Operation Copycat," in 1996. At that time, the Commission filed five cases, and the U.S. Postal Inspection Service, the States of Illinois, Indiana, Iowa, Pennsylvania and local authorities in Ventura County, California, and Aurora County, Colorado filed twelve others. The five Commission cases resulted in court orders banning certain practices, requiring performance bonds to be posted and awarding \$13.7 million in redress. In February 1999, the FTC, U.S. Postal Inspection Service and the States of Illinois and Indiana brought four cases as part of "Operation Clean Sweep," which targeted cleaning and janitorial supply fraud. Thus far, court orders entered in those cases ban individuals from telemarketing office and cleaning supplies and award nearly \$200,000 in redress. In December 1999, the FTC announced "Operation Misprint," with the FTC filing twelve cases and the State of Illinois filing two.²¹

¹⁹ Court-ordered redress in the 28 cases totals \$11,000,000. See Attachment 1 for a summary of the FTC's cases and education programs since 1986.

²⁰ Since 1995, the Commission has participated in 50 law enforcement sweeps.

²¹ In addition, as part of Operation Misprint, the Boilerroom and Telemarketing (BAT) Task Force executed search warrants at eight locations to gather evidence of possible wire fraud.

The Commission is pleased to announce that recent settlements and completed collection efforts in prior cases will return more than \$4.2 million to office supply fraud victims in the near future. In *United States v. Ultra Ribbons, Inc.*, an Operation Misprint case, a consent decree requires the company to pay an estimated \$100,000 in redress and \$500,000 in civil penalties for Telemarketing Sales Rule (TSR) violations, the largest TSR civil penalty ever.²² In *FTC v. National Maintenance Supply*,²³ a case filed as part of Operation Clean Sweep, the FTC and the co-plaintiff State of Illinois obtained a court order on February 8, 2000, awarding \$80,000 in consumer redress and imposing a ban on telemarketing office supplies on the individual defendant. Finally, the Commission soon will commence redress programs resulting from five cases that will return approximately \$4 million to small businesses and non-profit organizations.²⁴

BAT Task Force members include state and local California law enforcement authorities and several federal agencies.

²² The Ultra Ribbons settlement has been referred, as required by the FTC Act, to the U.S. Department of Justice, Office of Consumer Litigation, for filing on the FTC's behalf. Located in Southern California, Ultra Ribbons was an unusually large boilerroom, employing more than 700 telemarketers. It sold computer ribbons, printer cartridges and other supplies.

²³ *FTC v. National Maintenance Supply*, 99C-1057 (N.D. Ill.) (alleged deceptive sale of fluorescent light bulbs and urinal deodorizers).

²⁴ Those five cases are: *FTC, State of New Jersey and State of Michigan v. Sparta Chem*, 96-3228 (D.N.J.) (\$305,000; alleged deceptive sale of unordered cleaning and maintenance supplies); *FTC v. National Business Distributors*, 96-4470 (C.D. Cal.) (\$200,000; alleged deceptive sale of office supplies); *FTC v. MTK Marketing*, 96-230 (C.D. Cal.) (\$1.5 million; alleged deceptive sale of toner); *FTC v. North American Supply*, 95-4264 (C.D. Cal.) (\$826,000; alleged deceptive sale of toner); *FTC v. United Wholesalers*, 94-8620 (S.D. Fla.) (\$1.3 million; alleged deceptive sale of cleaning supplies). In *MTK Marketing*, the Commission also obtained the proceeds of a bond that the company posted to comply with California's Telemarketing registration law. The bond proceeds, \$100,000, also will be returned as redress to injured business victims.

The Commission also has taken action to ensure compliance with court orders. For example, after a federal court ordered it to stop deceptive telemarketing practices and to pay \$1 million in redress, a Florida toner-phoner continued to mislead small businesses into paying for unordered toner. As a result, the Commission sought and obtained an order finding the defendants in civil contempt of court, resulting in a ban from telemarketing for the defendants and an order to pay additional redress.²⁵ This matter is currently on appeal.

V. Project BOSS (Banish Office Supply Scams)

Preventing fraud in the first place obviously is preferable to prosecuting scam artists. Because of limited resources, the FTC and state and local officials can only detect and prosecute a portion of the fraud that is occurring, and even then, full redress for all victims is rarely obtained. Consequently, the FTC routinely alerts businesses and consumers about ongoing frauds and how to detect and avoid them. For example, for many years the Commission has published educational brochures about office supply fraud and has distributed them to associations representing businesses and non-profit groups that are frequently the targets of such scams.

Today the Commission announces "Project BOSS," its largest, grass-roots based business education initiative to date regarding office supply fraud. Project BOSS is a multi-faceted partnership to help the people who work at small businesses or non-profits spot and dodge fraud. Project BOSS involves extensive outreach efforts to organizations through new or expanded partnerships and new and traditional mediums. It includes issuance of new tools such as a Public

²⁵ *FTC v. Michael Chierico*, 96-1754 (S.D. Fla.) (In 1998, the court ruled defendants in contempt of the 1996 stipulated final judgment).

Service Banner Ad for the Web, new training materials, and distribution of an existing brochure, "Avoiding Office Supply Scams," initially issued in 1996 and revised in March 2000.

Grass Roots Components

- **Gateway For New Businesses.** The FTC and the National Association of Secretaries of State (NASS) have established a new partnership. Participating states will provide information on office supply and other business-oriented scams to new businesses that register with the state and provide links from their Web sites to the FTC.
- **Employee/Volunteer Training Assistance.** The FTC has prepared a tip sheet for organizations to distribute to staff or volunteers.
- **Industry Partnerships**
 - **Trade Associations.** The *Imaging Supplies Coalition*, the *Business Technology Association*, the *International Sanitary Supply Association*, which represents 4,100 manufacturers and distributors of cleaning and maintenance supplies used in commercial settings, and the *Office Products Wholesalers Association*, which represents 100 office supply wholesalers, have all agreed to distribute Project BOSS materials. The BTA and ISC will supplement their ongoing business education efforts by disseminating the Commission's brochures and other materials to their members and to their members' customers. In addition, some ISC members are taking extra steps to spread the word. Xerox, for example, has created a short video on telemarketing fraud that its sales force can play for customers from a laptop computer. The ISSA and OPWA, which are new

Commission partners, will send email and fax alerts to their members and print materials for redistribution to retail customers.

- **Business Newsletters.** In December 1999, at the FTC's suggestion, the American Chamber of Commerce Executives featured an article in its bi-monthly electronic newsletter to members and established a link to the FTC Web site.
- **Non-Profit Outreach.** To supplement prior outreach, the FTC will do a mass mailing of Project BOSS materials targeted to non-profit and religious organizations.
- **The New Road Show.** The FTC has prepared a Power Point presentation and speech package on detecting and avoiding office supply scams, which can be presented by FTC staff, state and local officials, or industry groups at meetings of organizations such as Chambers of Commerce and Rotary Clubs.

Other Initiatives

- **Cyber Tools**
 - **Dedicated FTC Web Page.** The FTC has created a new campaign page on the FTC Web site devoted to educating the public about frauds targeting small businesses, with links and information on where to file complaints with the Commission and other agencies and organizations. Go to:
www.ftc.gov/bcp/online/edcams/supplies/index.html
 - **A New Public Service Banner Ad.** The FTC has created a PSA on office supply fraud for use on industry and association Web sites; it allows visitors to link directly to information and educational materials on the FTC's Web site.
 - **Web Links.** The Small Business Administration, Better Business Bureaus,

Independent Office Products and Furniture Dealers Association, the National Federation of Independent Business, the Yellow Pages Publishers Association, the U.S. Chamber of Commerce and others have created or will create links on their Web sites to the FTC's Web site.

- **Media Education.** The FTC will mail 5,000 copies of the "Avoiding Office Supply Scams" business education brochure to media contacts to encourage stories about this fraud and its effect on local businesses.

VI. Conclusion

The Commission greatly appreciates the Committee's support and its putting the spotlight on this chronic and pervasive problem. The Commission has battled office supply fraud for many years in the courts and has undertaken substantial efforts to educate businesses on how to recognize and avoid the scam. Office supply fraud, however, continues to be a thorn in the sides of small businesses and non-profits and, thus, continues to be of concern to the Commission. We hope that our new grass-roots based campaign and today's hearing will help prevent more small businesses from becoming victims. Thank you for your assistance and for providing the Commission the opportunity to explain its work.