Summary

Research on advertising fraud

Background and research questions
Entrepreneurs in the Netherlands are regularly confronted with misleading offers to advertise in a magazine or have their name listed on a website. In addition, phantom invoices for services that were never rendered are sent out in bulk. In its most recent plan of action ‘Actieplan Veilig Ondernemen’ (AVO III) the Dutch public-private partnership, Nationaal Platform Criminaliteitsbeheersing (NPC), has included the fight against this so-called ‘advertising fraud’¹ as a separate project. This has led to a demand for more knowledge regarding the nature and background of the phenomenon in order to develop effective counter strategies and policy recommendations. As a result of this the Wetenschappelijk Onderzoek- en Documentatiecentrum (WODC) of the Ministry of Justice commissioned the Criminology Department of the Erasmus University Rotterdam to carry out research on advertising fraud.

The research focused on three questions:
1. What is understood by advertising fraud?
2. What is the nature and severity of advertising fraud? What is known about the scale of the problem?
3. What bottlenecks and constraints are being encountered in the preventive and repressive approach to advertising fraud and how can this approach be improved?

Research methods
A variety of sources and research methods were used to answer these questions. First, the database of the national support centre Steunpunt Acquisitiefraude (SAF) was used. This centre annually receives about 3,000 complaints filed by entrepreneurs, who have been the victim of advertising fraud. To gain insight into the nature and background of the phenomenon, 200 complaints submitted by victims were analysed using a checklist. A random sample was taken from approximately 5,000 complaints filed between January 2007 and March 2009 (26 months). Based on information from the SAF, three case studies were carried out, each of which focused on a particular form of advertising fraud. In these case studies, we examined the ways in which dishonest sellers mislead their customers.

To assess the extent of the damage caused by advertising fraud the banking sector was approached. Bank statements of 28 mala fide sellers were obtained through four major Dutch banks, which were examined with particular attention to payments made by customers.

Interviews (N=24) were carried out with experts and victims to gain a better understanding of the phenomenon itself, possible ways of combating it, and problems

¹ There is no suitable English term for what is known in Dutch as “acquisitiefraude”. In the English-language literature, “acquisition fraud” is understood to mean something else. This is why we have opted for “advertisement fraud”, although this term does not fully cover the subject of our research since “acquisitiefraude” can take other forms in addition to advertisement fraud. In essence, “acquisitiefraude” entails the use of misleading tactics to persuade customers into fraudulent listings - having their name registered in the form of an advertisement or listing in a magazine or database.
with the existing approach. In addition, a study was conducted of the relevant case law concerning the legal recourse available to victims of advertising fraud. In order to find out to what extent the police are familiar with advertising fraud and whether or not it is possible to file a criminal complaint, we called the central crime desk of each of the 25 regional police forces and presented them with a fictitious incident. Finally, an expert meeting was organised during which some of our findings and questions were discussed by nine experts with practical experience in the field.

**Working definition**

In this study, the term advertising fraud is understood to refer to ‘misleading business practices between organisations involving sales techniques aimed at building up trust and raising expectations with the purpose of persuading the other party to enter into a contract, while no adequate services are rendered in return’.

In the English-language literature, misleading business practices between companies are referred to as “business scams”. These scams can be perpetrated in all sorts of areas, from selling advertisements in magazines or listings in internet business directories, to the sale of office supplies or the services of ‘consultants’. Unlike “fraud”, the term “scam” conveys that the person involved in these practices is walking a fine line between a wrongful act and a clever or aggressive style of doing business.

With the new working definition we have broadened the range of misleading business practices, but we would still like to retain the term “advertising fraud”. This term is by now well established in the Netherlands and, moreover, it is the starting point and focus of the SAF. It determines the nature of the complaints received by the SAF and has accordingly determined the scope of our research. On the other hand, it has also imposed a limitation on our research, because the variety of other business scams that emerged from the literature could not be included in the research.

**Results**

All cases of advertising fraud have in common that the sellers are focused on obtaining the customer’s signature or consent in order to create a legally valid contract obliging the customer to pay for services to be rendered. It is basically unimportant what is being offered, since the sellers have no intention of ever providing any substantial service in return. It is only after receiving the first invoice that most customers realise what they have signed up for. All victims indicated that they would never have agreed to the contract if its terms and conditions had been clear from the start. The cases we examined demonstrate that misleading business practices can involve various products and services, ranging from an advertisement in a magazine, a listing on an internet directory site or a CD-ROM, a domain name registration, to a phantom invoice.

**Modus operandi**

Two forms of advertising fraud can be distinguished: the mass approach and the targeted approach. The **mass approach** involves the sending of a document containing an offer disguised as a “free registration” or an invoice (“phantom invoice”) to a large number of companies. The deception lies in the presentation of the document and/or offer, which is intended to evoke confusion. A recent mailing by the company *Kantoor voor Klanten (KvK)* can serve as an illustration. The layout of this seller’s
website and phantom invoice closely resemble the house style of the Kamer van Koophandel (KvK) (the Dutch Chamber of Commerce).

The targeted approach usually involves telemarketing: the customer receives an unexpected call from the seller, with whom he has no prior business relationship (also known as ‘cold calling’). In this more personal approach we can distinguish between two separate “acts” in the execution of the fraud. In the first act, the seller will say anything to gain the customer’s trust and raise positive expectations; every action is geared towards obtaining the customer’s consent. The second act involves the settlement: the seller will now, by any means necessary, try and enforce payment from his unwilling customer.

During the conversation in the first act, the seller may claim that there is an existing business relationship, or that a colleague has already confirmed the order, and that all the customer has to do is have someone examine the business details presented at an earlier stage. The seller also takes advantage of everyday expectations and will give the impression that the amount stated in the offer is the price per year, when it is actually the price per month. The design and layout of the proposal are carefully constructed to divert attention from the small print containing the general terms and conditions.

The sellers use subtle manipulation techniques and a number of misleading strategies to gain the trust of the customer. They may try to cultivate an image of respectability by hitching a ride on the back of reputable organisations. They may hint at a partnership with a well-known organisation, or deliberately cause confusion by using company names and logos that are almost indistinguishable from those used by respectable firms. This form of imitation, aimed at misleading the target, resembles a type of behaviour known in biology as mimicry. Just like respectable companies, mala fide operators also engage in impression management. They are officially registered with the Chamber of Commerce, the tax department and a reputable bank. To all appearances, they have an impressive office in Amsterdam, a professional website, and they send out well-designed invoices. Some of them have even set up their own support centres or try to create a favourable image by sponsoring projects and organisations. These initiatives give the impression of honest and professional entrepreneurship, but nothing could be further from the truth: the actual work is done at another location, the website consists almost entirely of links, and the documents contain spelling mistakes and grammatical errors. Some sellers rent virtual office space to make it seem as if they have a luxurious office in, for example, Amsterdam, when in reality all mail and phone calls to this address are forwarded to the actual location from where the seller operates.

It is important to the mala fide seller that the customers who have agreed to his offer fulfil their financial obligations (“act 2”). Of course, entrepreneurs who realise they have been misled will try to free themselves from the clutches of the seller, for example by contesting the validity of the contract by letter. This may lead to the seller proposing a settlement resulting in a shortening of the contract period. If both parties are unwilling to compromise, the seller sometimes calls in a debt collection agency or will threaten to do so. Some dishonest sellers are also not afraid to start civil proceedings to enforce payment, as became apparent from our examination of the case law.
Sellers
In 2008, the SAF received about 3,000 complaints about advertising fraud involving some 250 mala fide sellers. Foreign sellers are apparently active on the Netherlands market (14% of the 200 files). Remarkably, Dutch operators are often located in the northern part of the country (53%).
Both the case studies and our analysis of the SAF-files demonstrate that the mala fide companies are often affiliated with each other. Usually, several small subsidiary companies that engage in misleading offers are controlled by a ‘holding company’.
It is relatively easy to establish a small company and subsequently make it disappear from the market. The ephemeral nature of these companies and their activities makes it difficult to find the actors behind the operation. The location where the company’s business activities are conducted is concealed by the use of acquaintances’ addresses, the renting of virtual office space or the establishment of legal entities abroad.

Victims
Organisations and individuals affected by advertising fraud are frequently reluctant to file a complaint. Not all victims realise they have been misled, and those who do are often too embarrassed to report it. As a result, the complaints registered by the SAF only represent a fraction of the total number of affected customers.
Organisations throughout the Netherlands are being approached by mala fide actors with misleading offers. Although the report often mentions ‘entrepreneurs’ as the dishonest sellers’ primary target group, government services and the subsidised sector are also targeted. Among the victims in the files, the bank accounts, and the case studies, we found public organisations, educational institutions and particularly the health sector. Nevertheless, most affected by advertising fraud are commercial enterprises, both in absolute and relative terms.
It is not just the small inexperienced, novice entrepreneurs who fall victim to misleading business practices. Large organisations such as insurance companies, bank branches, hospitals, employment agencies and computer firms are also affected by advertising fraud.

Damage
Given the general unwillingness among victims to file a complaint, the registered complaints are an inadequate starting point for estimating the financial damage caused by advertising fraud. To get an approximation of the damage, we examined the transfers to 28 bank accounts held by mala fide sellers, covering a total of 191 months. Since our research focused on a limited number of accounts and the period examined was different for each account. Based on our findings it would be unwise to make any firm pronouncements about the total damage caused by advertising fraud.
How much a mala fide actor can earn on a scam depends on, among other things, the services offered, the terms of the contract (price, duration, frequency of payment), the duration of the scam, and the size of the mala fide company. There are operators who have a solid source of income throughout the year because their customers are bound by three-year contracts and quarterly payments. The customer, on the other hand, may be much less aware of the total costs spent on, for example, a listing on the internet, since he is paying in instalments.
The bank transfer records also show that some mala fide sellers are, without a doubt, raking in vast amounts of money. One of them received 2.5 million euros in his account within a period of seven months, although admittedly this person’s profit was offset by significant personnel costs and tax payments.
The number of transfers by misled customers is considerable. Because most sellers have several bank accounts, it seems not unreasonable to assume that their earnings are much higher than our findings indicate. It would therefore be unjustified to treat advertising fraud as a petty crime.

**Legal possibilities and obstacles**

There are two ways to tackle advertising fraud: one is to pursue individual cases, the other is to employ a situational preventive approach. Misled customers have recourse to contractual as well as criminal remedies. Depending on the circumstances of the case (manner of deception, products or services offered) there are several civil options to contest the validity of the contract. The customer may claim that he had no intention to enter into an agreement (absence of mutual assent, article 3:33 BW), or, alternatively, claim misrepresentation (article 6:228 BW) or deception (article 3:44 BW) because the seller made misleading statements. Another option is to appeal to failure to fulfil an obligation (article 6:74 BW) because, accepting that there is an existing contract agreed on by both parties, the seller has failed to deliver an acceptable level of service.

The majority of misled entrepreneurs are reluctant to go to court. If the customer has already paid a number of instalments, this fact is likely to increase the chances that his claim will be dismissed. In addition to this type of probability calculation, the risks and costs of a lawsuit will obviously play a role in the customer’s decision to start civil proceedings. These costs usually outweigh the relatively minor damage caused by advertising fraud.

Misled customers willing to initiate civil proceedings often discover that the furnishing of proof can turn out to be a major hurdle. After all, a victim does not look good in court when he claims that he never wanted the contract in the first place, when the seller produces a signed agreement with the general terms and conditions clearly stated in the small print. The problem is of course that misleading sales tactics were used during the initial conversation.

The Unfair Commercial Practices Act protects consumers against misleading practices very similar to those faced by entrepreneurs. According to our respondents, the same prohibitive rules should be extended to also apply to advertising fraud.

From a criminal justice perspective, the activities of *mala fide* sellers can be termed swindling (article 326 WvSr) and/or forgery (article 225 WvSr). When victims opt for a criminal approach, they can also run into obstacles. The police and the justice department are generally hesitant to take on complaints of advertising fraud. Our research, in which we reported a fictitious case to a number of crime desks, suggests that the police are not eager to file a complaint. Of the 25 police forces we contacted, only two immediately recognised our story as a form of swindling. In all other cases we were told that it was impossible to file a report because no punishable act had been committed. The argument that misleading business practices constitute a civil matter, which precludes a criminal approach, seems to influence the assessment of advertising fraud as a criminal priority. The police also do not have a clear idea of the scale and severity of the problem, with the probable effect that the problem is underestimated and that individual complaints regarding advertising fraud routinely receive a low priority. We found that the Public Prosecutions Department is equally reluctant to take action in cases of advertising fraud, although the phenomenon is mentioned in policy documents as worthy of attention.
A successful conviction is difficult to secure, because in a case of swindling both intent and the use of fraudulent means must be proven. In addition, it must also be demonstrated that the victim entered into the agreement as a result of those fraudulent means. There is also no denying that the mala fide sellers usually deliver at least a minimal performance and have therefore not completely and demonstrably failed in fulfilling their obligations.

*Situational preventive approach*

Advertising fraud can also be combated by a situational preventive approach. This approach entails, first of all, reminding companies of their own responsibilities and their duty to arm themselves against misleading business practices. Public education campaigns could also contribute to the awareness of misleading offers among Dutch entrepreneurs.

In addition, barriers could be erected by various parties in the chain of business. *Mala fide* sellers are able to carry out their misleading business practices because they are facilitated by service providers. They can buy up private limited companies, set up websites, use virtual offices and hold several bank accounts without any difficulty. A situational preventive approach should therefore be aimed at blocking the display of respectability and making it more difficult for the sellers to abuse other people’s trust and to force them into paying. From the perspective of corporate social responsibility, service providers should be alert to the possibility of misuse of their services and remove *mala fide* clients from their list of customers.

Dishonest sellers also use the logos, portrait rights, and business names of *bona fide* organisations. As the injured parties, these organisations could sue for infringement of intellectual property rights. Trade associations could also make a stand by awarding quality marks, with the purpose of excluding *mala fide* sellers from the sector and sanctioning facilitators within their ranks.