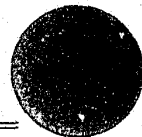


MAIL FRAUD



HEARING
BEFORE THE
SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON
POST OFFICE AND CIVIL SERVICE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

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MAIL FRAUD

THURSDAY, NOVEMBER 14, 1985

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTIGATIONS,
COMMITTEE ON POST OFFICE AND CIVIL SERVICE,
Washington, DC.

The subcommittee met, pursuant to call, at 11 a.m., in room 2203, Rayburn House Office Building, Hon. Gerry Sikorski (chairman of the subcommittee) presiding.

Mr. SIKORSKI. The subcommittee will come to order.

This is a hearing before the Subcommittee on Investigations of the Post Office and Civil Service Committee. Under rule X of the House, this subcommittee is charged with the responsibility to examine, among other things, the operation and administration of the U.S. Postal Service. Today the subcommittee will be reviewing the incidence of mail fraud, particularly c.o.d. fraud, occurring as a result of so-called boilerroom operations. Also, we will examine the effectiveness of the prevention enforcement programs of the U.S. Postal Service.

With evidence that this fraud is increasing and with the holidays upon us, the subcommittee has become increasingly concerned with illegal boilerroom operations, fly-by-night, white-collar con operations peddling phony products ranging from precious metals to copy machine toner, college scholarships to health spas, and \$300 satellite dishes, fishing boats, to advertisements in fictitious newspapers. By using telephone banks and making hundreds of thousands of calls to people all over the United States, these con artists use high-pressure sales tactics, lies, deception, and the U.S. mail to ensnare their victims. Their marks are nationwide, with the unscrupulous boilerroom operators targeting the most vulnerable: the elderly, hoping to find the best return on their limited resources; the young, competing for ever-shrinking college scholarships; and distraught parents hoping to find their missing children. But the typical victims—suckers, in boilerroom lingo—are neither hapless nor gullible. They include the sophisticated and the unsophisticated alike, the educated and the uneducated. They are Midwest widows and immigrant families as well as partners of Wall Street firms, bankers, lawyers, and executives, all trapped in elaborate ripoff scams that can fool even the experts.

Forbes magazine recently characterized the proliferation of these consumer con games as, "the most devastating epidemic of investment swindles in the history of the United States, even greater than in 1919." The real cost to Americans is incalculable, but one recent investigation estimated that these contemporary investment

scams, rake in more than the underworld does from illicit drug dealings, more than \$40 billion a year. Last year, tax shelter frauds alone robbed the public and the Treasury of \$25 billion.

Flimflam men and boilerroom operations are not new. Strong-arm tactics that gave boilerrooms their name date back to the 1920's, when salesmen sat elbow to elbow in cramped offices promoting worthless penny stock by phone. That is still going on today. Twentieth century telecommunications, telemarketing, electronic mail, and c.o.d. make these computer age con games alarmingly easy to play. Today you can get pitched from southern California, "the con man's capital of the world," or from Miami's Maggot Mile. It's cheap and easy to set up a boilerroom. For a few thousand bucks, a couple of rooms are rented, some phones are installed, and an ad is placed in the newspaper.

Lists of potential marks, taps, or leads, as they are referred to by boilerroom operators, are readily available from phonebooks and professional mailing list companies. Well rehearsed pitches, or spiels, are made to the so-called suckers to close a deal. Thanks to "800" numbers, the operators no longer have to get out of town before the victims go to the police. They are never in town in the first place. They are just a voice at the other end of a telephone in another city, reciting a litany of false promises, and using phony billings, pseudo-advertisements, and misleading statements. When the outcry catches up with them, the crooks simply move to another office in another State or just on another street in the same city and resume their predatory ways.

Hence the four F's of boilerroom frauds: Fleece funds and flee fast.

The con artists and their helpers are lured by the promise of warm weather, illegal drugs, and easy money. Working a few hours a day, they can average \$30,000 a year or more in commissions. A take of \$250,000 is not uncommon, low-lives leading the good life.

There are scams targeting the rich and scams targeting the poor, scams for those who like figures and glossy brochures, and scams for people who get dizzy by figures and brochures. Consider the case of a semiretired hotel operator from Minnesota who lost more than \$100,000 in a gold and silver swindle and then turned around and lost \$44,000 more in another commodities scam. Scams have trapped the likes of Woody Allen and Erica Jong. Even economist Arthur Laffer and investigative columnist Jack Anderson have been zapped.

Thus, we're witnessing the emergence of a new classless class of victims: rich and not rich, informed and uninformed, young and old, from Miami to Los Angeles to Minneapolis, from Wall Street to Main Street to Rural Route 2.

The question is, Where are the regulators? They tell us they're trying hard, and I am convinced they are. But they are simply swamped. The fact is, boilerroom operators have devised hundreds of ways to avert, avoid, and escape the law. It doesn't help when they use laws to aid and abet their operations. They use current c.o.d. law to turn your mailman into a collector for crooks, a middleman for the flimflam man.

The dollars are mushrooming. The techniques are computer age. The crooks are numerous and smart, the regulators few and out-

gunned, and the victims growing and too often silent. That is why we are here today, to examine the scope of the problem and assist the regulators in protecting American citizens. It is particularly encouraging that some States have already taken action against boilerroom operations. The subcommittee congratulates the State of Florida and Comptroller Lewis for Florida's aggressive enforcement of anticonsumer fraud laws and thanks the FBI and the Postal Service for their help and cooperation.

We are particularly pleased that we have succeeded in refocusing attention on this growing problem. We commend the U.S. Postal Service for being so responsive to the public's concerns in proposing important reforms to the c.o.d. system which will be announced at the hearing today.

Our first witness will be Neil Murray, of the On Your Behalf consumer advocate television show on one of the principal news stations in Minnesota. He has had extensive experience with victims of these boilerroom operations. Neil has, frankly, done yeoman's work over the last 12 years in trying to educate consumers to the dangers of these fly-by-night operators. Neil will be accompanied by Fred Royle, a boilerroom victim who runs a small construction business in my district. He has brought with him the three-man fishing boat that was supposed to be worth several hundred dollars, including an inboard/outboard motor; you can have it either way.

Neil, we welcome you. Our tradition here at the Investigations Subcommittee is to swear in all our witnesses. If you don't have any objection to being sworn in, I ask you to raise your right hand.

Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. MURRAY. I do.

Mr. SIKORSKI. Great. Go ahead.

TESTIMONY OF NEIL MURRAY, INVESTIGATIVE REPORTER, ON YOUR BEHALF, KSTP-TV, MINNEAPOLIS, MN, ACCOMPANIED BY FRED ROYLE, MOUND, MN

Mr. MURRAY. When I became an investigative reporter back in 1975 at KOAT-TV, the ABC television affiliate in Albuquerque, NM, the largest single category of consumer complaints was ripoffs through the U.S. mail: Earn extra money, even get rich through work-at-home schemes, stuff envelopes for hundreds of extra dollars monthly. Such magazine and through the mail ads are generally aimed at shut-ins and the elderly. I could have made a living airing weekly presentations on the sad cases of old people and the bedridden who were taken by ripoff artists who duped them through the U.S. mail.

There were no envelopes to be stuffed. There were no companies waiting for the elderly and shut-ins to stuff their envelopes. Looking back, I did make quite a bit of my living airing mail fraud problems because they were the simplest to prove always. It's no secret that mail fraud is against the law. It is also no secret that there was not much my office could do to put a stop to such ripoffs.

We contacted postal inspectors. They looked into these complaints. They resolved some cases, but the cases kept coming. The

list of victims kept growing. Postal inspectors are still investigating but the list of victims is still growing. Now we have entered a high-technology era of the 1980's. It has become easier to confuse consumers. It has actually become easier to confuse practically everyone, as evidenced by the magnitude of ripoffs that are on the rise today. Smalltime shysters who took advantage of the unsuspecting through the 1970's have now evolved into the much more sophisticated big-time shysters of the 1980's. They are smart enough to know that they can take advantage of consumers by ripping them off through the U.S. mail and not having to worry much about being brought to justice before they can make a bundle.

The smalltime work-at-home-scheme ripoffs are still being offered across the country, plus people are now being taken for thousands of dollars by shysters who having figured out how to use the U.S. mail service to their advantage, to our disadvantage.

One of the main sources for gathering complaints and inquiries regarding questionable operations in any State is the better business bureau. The Better Business Bureau of Minnesota has been overwhelmed with complaints on c.o.d. and mail fraud ripoff. I asked its president, Ron Graham, to provide us with information from his office that we could include in this presentation. I would like to have this introduced for the record.

Mr. SIKORSKI. Without objection, so ordered.

[The support data furnished the subcommittee was retained in the official file.]

Mr. MURRAY. The letter starts:

Dear Neil, this is in response to your request for an analysis from this office reporting the extent of promotional schemes targeting business firms with c.o.d. offers which are believed to be subject to investigation as fraudulent. During the past 2 years, the Better Business Bureau of Minnesota has observed an increase in the number of reports of such offers as received by area business firms. The bureau has regularly issued warnings on these scams. Copies of two member bulletins are enclosed.

Currently, it is estimated that 15 to 20 c.o.d. inquiries are received daily in the Better Business Bureau of Minnesota office.

Most businesses we have surveyed report they are regularly the subject of c.o.d. promotions. In cases where formal written complaints are received by the better business bureau, they are presented to the U.S. Postal Service. During the past 2 years, the bureau estimates that over 50 companies have been the subject of formal complaints. For purposes of this report, the bureau has reviewed the record of 12 companies for 2 years. The 12 companies, primarily based in California, were the subject of 190 written complaints. All reported they were offered gift items of substantial value. These included satellite dishes, boats, catalogs, grandfather clocks, luggage, TV sets, gemstones, vacations, and telephones. The complainants reported they were required to purchase only promotion items such as imprinted pens, c.o.d., or pay shipping and handling, c.o.d., in order to receive the so-called gift.

An analysis of the 190 complaints reveals that 41 reported the promotion but did not pay; 149 paid for the items and claimed that the quality and value of the so-called gift items were grossly misrepresented and that the c.o.d. procedures prevented a recovery of their money. The 149 complainants paid a total of \$24,622.48, an average of \$165.25 per transaction.

As the reports of this nature continue on the increase, the Better Business Bureau of Minnesota also has been contacted by reputable direct marketing firms indicating their concern over the practices reported by the bureau. At the national level, the Council of Better Business Bureaus has issued many warnings and has published a brochure entitled "Schemes Against Businesses," and an alert entitled "Advertising Specialty Product Promotions and Contests." Copies of the brochure and the alert are enclosed.

Telephone boilerroom and direct mail schemes targeting businesses present a growing problem of increasing economic consequence particularly to small business firms which are now the primary targets of such schemes.

Signed, Ronald J. Graham, President of the Better Business Bureau of the State of Minnesota.

Through the years, I have actually grown a bit tired of airing presentations on ripoffs through the mail, but I cannot ignore these complaints because my office, the On Your Behalf office, now after 8 years in the Minneapolis-St. Paul market, is depended upon by many for both large and small problems. Every piece we air is designed to accomplish two things: One, to solve the problem; and, two, to educate the viewers. Resolving mail fraud problems one at a time has become a joke. Attempting to educate people who have grown to adulthood without knowing is hit and miss, at best.

The shysters who use the mails today are very intelligent. They are no longer the one or two guys with a telephone and a few dollars for making copies. They are well-versed in their crooked methods. They now seem to be concentrating on small businesses. Actually, they are making a killing on small businesses. The more intelligent the business person, it seems the more they are apt to be taken, the more they are apt to be taken for.

Warnings apparently do not work. Nowadays, the On Your Behalf office receives more mail fraud complaints; namely c.o.d. ripoff complaints, than we could put on television.

Is it possible to leave our c.o.d. system as it is and wipe out the shysters by educating the public? I say "No, absolutely not." I have tried to do that for 10 years in two different States. I am told the postal inspectors have been attempting to educate the public. The better business bureau has been educating the public. This is November 14, 1985. The public is still dumb. We have failed. We are failing.

Our public schools are not doing well in attempting to educate America on a full-time basis. Why do we expect to accomplish that on a part-time basis? Old folks just don't seem to have what it takes to avoid ripoff schemes, frankly. The fact that something is too good to be true seems to attract them. When offers are unbelievable, they choose to believe. Why? Because they all want something for nothing. They all seem to think that Santa will come c.o.d.. They are all primed for that good deal.

Our last attempt to educate our unsuspecting public was just the middle of last month, October 15 through 18, in a series we called c.o.d. Ripoff. And since all of our other approaches seemingly have failed, this time we chose to communicate through the universal language, music. Many viewers—it has been a month now—remember this presentation, but the list of victims is still growing; and it needs to be stopped. We came here today to cry help.

Mr. SIKORSKI. I am going to run for a vote, but I want you to introduce the video tape and then they will play the piece that you did highlighting this problem. I should be back within about 7 or 8 minutes, so that will fit in real nicely. Then I will take up with questions, if that is OK. So, why don't you go ahead and introduce the tape and play it?

Mr. MURRAY. This is a four-part series that we aired October 15 through 18 this year, entitled "c.o.d. Ripoffs." And it's self-explanatory.

[Audiovisual presentation.]

Mr. SIKORSKI. You've been hearing complaints now from boiler-room victims for over 12 years from a couple of different States. And the problem is not diminishing, it's growing, in fact. Isn't that true?

Mr. MURRAY. It's growing.

Mr. SIKORSKI. Are you getting more complaints than ever before?

Mr. MURRAY. More complaints, wider ranging complaints.

Mr. SIKORSKI. Do you think they're calling you because consumers are better informed, know about you, or because there are just more of these scams going on?

Mr. MURRAY. After 8 years in the Twin Cities, more consumers know about us, but a large percentage of those who contact us have already been duped. They've just become a bit nervous after they take advantage of the scheme, and they call us anyway.

Mr. SIKORSKI. Obviously, a part of the process of convincing people not to buy into these things is consumer education. But you've said quite frankly, that can't be the only solution.

Mr. MURRAY. I don't think that's any of the solution, not to this point.

Mr. SIKORSKI. You've done these news reports, and there have been public service announcements, and other things. In your experience, Is the Postal Service doing a better job at catching these people?

Mr. MURRAY. The Postal Service is always in there somewhere. We can take our stuff to them. But the list is still growing. No matter what they are doing, and I am told that they are educating the public, the list is still growing.

Mr. SIKORSKI. You have watched the evolution of boilerroom scams for years. Do you see any changing trends in the types of victims that are being hit by these?

Mr. MURRAY. As I remember, they used to go after the people who were the most helpless: the elderly people, shut-ins. Now they still go after those, but now they are going into small businesses and bigger businesses.

Mr. SIKORSKI. There's more money with the people——

Mr. MURRAY. They are going after more money and they're getting it.

Mr. SIKORSKI. The Forbes article talked about how there is more money available to the middle class, with high rates of interest and inflation during the late 1970's and early 1980's. They became a major new class of victims for these operators.

Now, we all know it's a tough problem, but do you think the Postal Service can be more aggressive, put more resources and just be more aggressive on this issue?

Mr. MURRAY. I have never known exactly what the Postal Service does or what postal inspectors do. I know they attempt to educate the public, and they do catch up with some of these people. With what they have now, could they do more? I don't know. I haven't seen it.

Mr. SIKORSKI. In your first letter to me this summer—and in your piece you talk about how the mailmen actually become the collector for these flimflam men. Do you support the changes in the c.o.d. system recommended by the Attorney Generals' Association?

Mr. MURRAY. If that's the only proposed change, I'll support it. But I am not here to dictate what should be done. I am just here to say that something has to be done.

Mr. SIKORSKI. Great.

Fred, do you want to come up? Do you have prepared testimony or a statement?

Will you raise your right hand?

Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. ROYLE. I do.

Mr. SIKORSKI. Thanks, Fred.

Mr. ROYLE. Mr. Chairman, the reason that I am here this morning is that I was recently ripped off through the local postal system, and I would like to stand up for the average consumer to ask you to help us to stop this type of dishonest business. My charges are not being leveled against the postal system, since they have just become the innocent pawn in a sometimes cruel game.

Thousands of us are being sucked into believing that, if we pay cash on delivery for items sent through the mail, we will receive what we were promised, only to realize later that we have been hooked and we've got no recourse.

My case is no different than thousands across our Nation. On or about May 14, 1985, I received notification that I had won a national sweepstakes; and my prize was a Mariner 3000 three-man freshwater sport fishing boat with an inboard trolling motor. Of course, I called the distributor, United Federal Distributors in Venice, CA.

When I called, I was told by one of their salesmen that I had indeed won a, quote, "1985 Mariner bass boat capable of carrying three adults and all of their fishing gear," unquote. I was told that they had been given 1,500 boats to use as prizes by Mariner. Mariner wanted us to try this new model out and give it some exposure on the lake. We would be sent a questionnaire to fill out later.

My only responsibility was to assume the shipping, freight, and gift tax of between \$270 to \$290. This seemed reasonable, since I thought we were speaking of a full-fledged, honest-to-goodness bass fishing boat capable of transporting my family to days filled with relaxation and fishing ecstasy. After all, nothing does come free.

I was told that, if I sent them \$247, they would cover those charges, getting a tax writeoff, and they would send me 120 pens which I could use as a tax writeoff. In an illogical way, it sounded logical, and I agreed to the deal. Just before hanging up, I was told that there would be an additional charge received with the pens of \$59.90 to cover local destination charges, which also had to be paid before I received the boat.

Let me say at this point that I was not purchasing pens, but rather paying the charges to deliver a Mariner 3000 three-man bass boat, complete with a trolling motor. The pens were incidental.

Being the skeptic that I wish I could be more of, I asked for and received a complete list of specifications. And being satisfied, I

went ahead with the deal, paying cash at the post office for a box of pens. Enclosed was the bill for \$59.90. At this time, I called them and asked for a release from the local charges, since I could easily pick up the boat at the warehouse in Minneapolis with one of our company trucks. I was told that this cost was built in and couldn't be separated. So, I paid it.

A few weeks later a box arrived at our back door that cost United Federal \$6.95 to ship from California.

Mr. SIKORSKI. That's the box your three-man Mariner 3000 boat came in?

Mr. ROYLE. That's the box, \$6.95 it cost straight from California. There were no local destination charges.

When I opened it, I realized—I thought originally it contained my heavy duty oars and motor. I was excited at that point. But when I opened it, I realized that I had been taken; and I called the Better Business Bureau. And here I am, the not so proud owner of an inflated rubber raft and a deflated ego.

Mr. SIKORSKI. At least you can laugh about it.

Mr. ROYLE. Yes.

My brother-in-law and I are partners in a small construction firm in Minneapolis. We've been in business for approximately 7 years. We have named our company after Christ the carpenter, and we have made every attempt in those 7 years to hold His principles of honest work, fairness and full measure as a No. 1 priority. It has been a tough but rewarding experience, but applying these principles to our business has brought us more business than we can possibly handle.

This is why I find it hard to understand why companies like United Federal Distributors feel they have to cheat. But since they do, we must do our part to slow them down. The laws relating to the use of c.o.d. purchases through the U.S. mail system must be changed to protect the unwary like myself.

Thank you.

Mr. SIKORSKI. Thanks, Fred. Thanks for your willingness.

One of the problems we have—and I think, Neil, you mentioned this—is that many of the victims just swallow their pride and stay silent. It's not easy for Jack Anderson, the investigative columnist, or Dr. Laffer, the big supply-side economist, as well as Woody Allen and other people to admit that they were taken themselves. Of course, Woody Allen could use it for tax purposes and put it into his next movie or play.

But you are willing to stand up and tell us about it. Fred, you got a U.S. Coast Guard identification number with it.

Mr. ROYLE. That's right. I asked for the set of specifications on the boat. The first specification said it was U.S. Coast Guard I.D. number MNR30001A585. Number five said it had electronically welded seams.

Mr. SIKORSKI. Electronically welded seams on a rubber raft.

Mr. ROYLE. Right.

Mr. SIKORSKI. A flat bottom. You got the flat bottom.

Mr. ROYLE. We did get the flat bottom. We got everything they claimed.

Mr. SIKORSKI. You got——

Mr. ROYLE. Plus the shaft. There's an electric inboard engine with a solid brass shaft. Would you like to see that?

Mr. SIKORSKI. Yes; maybe you can come up to the front here. A Mariner 3000 three-man sport fishing boat, heavy-duty oar locks.

Mr. ROYLE. I don't know if any of you are bass fishers, but the idea—

Mr. SIKORSKI. The idea is to sneak up on them.

Mr. ROYLE. Yes, to sneak up on them with a silent and very powerful motor that it's supposed to be. This particular one is neither silent nor powerful.

Mr. SIKORSKI. Have you been able to put that motor in with that raft?

Mr. ROYLE. For the show we put it in the raft, started it up, and the propeller fell off and sank to the bottom of Lake Minnetonka.

Mr. SIKORSKI. Does the motor move the boat?

Mr. ROYLE. We don't know. We never got any farther than trying the oars, which bent as we used them.

Mr. SIKORSKI. You called the Better Business Bureau. Did you also talk to the Postal Service?

Mr. ROYLE. No, I didn't. I wasn't aware that they should be contacted on it.

Mr. SIKORSKI. Do you know if this company is still in business?

Mr. ROYLE. I would assume that they are. This just happened a few weeks ago.

Mr. SIKORSKI. Have they tried to sell you anything else?

Mr. ROYLE. No.

Mr. SIKORSKI. You were aware that these schemes existed before you bought in?

Mr. ROYLE. Sure, but mainly to the elderly, I thought. They seem to be duped so easily. I am an educated man, and I have been in business for 7 years, competing against the ripoff artists that are in my trade. So, I know they are out there. But it doesn't happen to me.

Mr. SIKORSKI. Do you want to tell anything more about this saga?

Mr. ROYLE. Yes. I have another boat coming. I was contacted—let me go into this. I have a partner, and we split everything 50-50. My name is on this boat. The company name is on it as well. I envisioned glorious weekends in the bass boat with my family, but so did he. So, consequently, I could see a real problem developing. We agreed that there wouldn't be a problem. But a few days later I received a notification in the mail that I had indeed won another bass boat and that I should call immediately to claim the prize. And I felt like this was a good decision; I've got two of them. The computer just glitched my name out. So, I was sucked in it one more time.

Mr. SIKORSKI. For the same amount?

Mr. ROYLE. Very similar.

Mr. SIKORSKI. It hasn't come yet?

Mr. ROYLE. No, because of the Christmas rush, they claim.

Mr. SIKORSKI. We will ask the Postal Service to follow up on it.

Mr. ROYLE. I appreciate that.

Mr. SIKORSKI. Neil, did you follow up on this particular case? Is this business still in operation?

Mr. MURRAY. That business is still in operation.

Mr. SIKORSKI. Got one more rubber raft coming.

Mr. MURRAY. There are quite a few—after we had the series, and our people just send us the contact papers they received from this company, and they have escalated. Now they have a new scheme where they are offering a \$10,000 check or a Winnebago or a small airplane. I don't think anyone who fell for that would be willing to go on TV, so we haven't heard from them.

Mr. ROYLE. May I add one more point?

Mr. SIKORSKI. Yes.

Mr. ROYLE. I have, in effect, won four boats. I have only taken two.

Mr. SIKORSKI. You won four.

Mr. ROYLE. My odds are fairly good, I guess.

Mr. SIKORSKI. Chances are, from what I understand, you are going to be hit repeatedly.

Mr. ROYLE. That's what I understand.

Mr. SIKORSKI. Your name is going to be on the list that go with these sales people to the next boiler room operation and be sold and transferred.

I was thinking, about cases where I was phoned when I was in charge of purchasing things for an office, and I in fact had been contacted; but I didn't have the time to talk at that point and never got to call back. But I am sure I would have been just as much a potential hit as any one of us.

Thank you very much for your willingness to share this with the entire Nation and help educate people about this. We have truly appreciated it. Neil, thank you for bringing this to the subcommittee's attention and for your work in this area. It has been very helpful to the subcommittee. Thank you.

Mr. ROYLE. Thank you.

Mr. MURRAY. Thank you.

Mr. SIKORSKI. The next witness is going to take a little while to set up. I would like to bring him in at this point. He has requested anonymity. We are fortunate to have him here today as a man who himself was a boiler room operator. His hands-on experience with these operations will help us all better understand exactly how they operate and how they are so successful in what seems to offer something too good to be true.

I want to take this time to thank the Postal Service and the FBI, Mr. Lewis and the State of Florida for their extensive help, and the two people who just testified, as well as this next witness, who is doing so even though he has cleaned up his act. He has nothing to gain from the justice system at this point. He has served his time. But he is willing to come at some distance to assist us in trying to clean up these scam operations across the country.

You may come up here. I am not going to ask your name for the record. We are aware of your name. We have asked you if you have any objection to be sworn in. If not, would you raise your right hand?

Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. X. I do.

Mr. SIKORSKI. I think for your protection and comfort, we are going to put you down behind that table and microphone, bring up

that screen behind you, and ask that no pictures of this gentleman's face be taken or film be taken. And then you can take your hood off after the screen is there to protect you.

Sir, do you have a statement you would like to make?

Mr. X, I don't know if you were here. I do want to reemphasize the subcommittee's appreciation. Before you came in, I noted for the record your willingness to appear here with nothing to gain. You have served your time. You have nothing from the justice system at this point to give you. We want to express our appreciation for your willingness to come out and help us on publicizing these problems.

Why don't you go ahead?

TESTIMONY OF MR. X, FORMER BOILER ROOM OPERATOR

Mr. X. Chairman Sikorski and members of the committee and guests, I am 41 years old. I am a convicted felon. I served a total of 3 years in Federal and State prisons for the crime for which I am going to try and describe today.

I pleaded guilty to charges relating to perpetrating commodities frauds. I agreed to help the government with its broader investigations and to testify on behalf of the government at various trials. All of this was done over a period of 3 or 4 years.

I readily agreed to testify before this committee. Unfortunately, I became involved in several such schemes. And I can give you first-hand information about how these things are done. I am here totally voluntarily. I hope this committee and the public at large will benefit from this appearance.

I would like to tell you a little bit about myself because I think that it might help knowing where some of these sales promotion people come from. After some college, I pursued a career for myself in sales. Several people had remarked to me over the years that I was a natural-born salesman. I worked for one of the largest chemical companies in the world, as well as numerous other legitimate corporations, and did very well.

In 1977 I met a salesman in New York in an apartment building that I was living in who told me that he had made up to \$6,000 a week selling commodities. I didn't believe him. He showed me in his wallet four or five uncashed weekly checks, he was making that kind of money. It turned out that he was employed in what is commonly referred to as a boiler room operation. Now, a boiler room operation refers to any large room where there are banks of telephones with 50 or more people making calls in an effort to sell commodities or whatever. After being involved as a salesman in several of these operations on a full- and a part-time basis, I decided to go into business for myself.

Now, the first thing you need was an impressive-sounding name. I turned to the Wall Street Journal, and like a puzzle picked out names and put them together until I came up with a very distinguished-sounding name, hopefully, to impress the clients that we were going to try to sell. The next thing you need is an address, hopefully, in the heart of Wall Street. I rented a place on John Street in New York City. I recruited a crackerjack sales force. Many, by the way, of these people had been in business before, the

same type of businesses, or other types of scams, telephone scams, and brought with them a list of names of clients from other employment, other employers who they would again try to sell something new.

After June 1978, when the Commodity Futures Trading Commission banned trading in commodity options, our company as well as every other company in this type of business in the Wall Street area began selling essentially the same things as contracts for deferred delivery. The deferred delivery scheme for gold, silver, or currency, or other commodities, works as follows. It involves the contacting of potential investors by telephone salesmen using high-pressure sales techniques. In the initial telephone contact or front, the commodity is described as constantly increasing in value, with profit expectations between 40 and 50 percent of the original investment, and in some cases even much higher.

This phone call is followed by the firm mailing sales promotion literature to the customer, obviously through the U.S. Postal Service. A few days later the potential investor receives another telephone call, and this call is called traditionally the close.

Mr. SIKORSKI. The close?

Mr. X. The close.

Mr. SIKORSKI. First the front, then the close.

Mr. X. Exactly.

The salesman again describes the profitability of the investment on this particular commodity. He may also state a hypothetical profit had been made during the time that it took for the mail to get the promotional literature to the prospective investor.

Now, after the investor is convinced that he should invest through all types of high pressure techniques, the investor is instructed to send his money either by wire, bank-to-bank transfer, or by the U.S. mail. Now, this payment is believed to be by the investor a downpayment for the total contract price. The initial payment is really a nonrefundable commission, sometimes called a contango fee. Of course, the investor is never told this.

Mr. SIKORSKI. Why a contango fee? What is it?

Mr. X. A contango fee is a—

Mr. SIKORSKI. I understand what it is, but why the name? Is it just a made-up name?

Mr. X. I'm really not sure.

Mr. SIKORSKI. Is it some dance or something?

Mr. X. I'm really not sure.

Mr. SIKORSKI. OK.

Mr. X. It's something that, I understand, has been used in the securities industry for years and years and years. If you understand what it is about, then I guess that's sufficient.

Now, upon the receipt of the funds by our firm, a mail confirmation order or contract is then sent to the investor.

Mr. SIKORSKI. Before you get there, I know you've told us before that you try to get the person on the phone to stay there after you made the deal before they have a time to talk to wife or lawyer or doctor or whomever, or the Better Business Bureau. You get their account and their bank from them. You call the bank. You get someone on the phone. And you instruct them, write this down, do this, do that, do this, do that, and then have them call the victim.

They get permission from the victim. Then they wire it. So, within minutes after you've got the close on them, you've got the money in your bank in New York or wherever you are.

Mr. X. That's correct.

As an example, a Mr. Schmidt—and we'll just come up with a name—Mr. Schmidt of Carleton, TX, was contacted by one of my brokers in early 1979. Now, the broker, or so-called broker, absolutely guaranteed Mr. Schmidt that, if he wired his fee of \$3,500 that day, that he could realize a potential profit over a specified period of time of approximately 90 days, this profit being in excess of \$15,000. Now, Mr. Schmidt was very reluctant to give up his \$3,500. The trick, if you will, to get Mr. Schmidt to do that wire transfer right then and there was urgency. And he was told in ways such as: if you don't invest now, I cannot guarantee to hold this contract for you any longer. I have a limited number of these contracts. Have you read the newspaper? Have you been following the market? Do you understand what's going on in Iran? Do you understand this? Do you understand? You ask him an awful lot of questions that are generally well known by most people who watch television.

You play upon the urgency factor, that he must do it right then and there. The next step, once you've got him to agree, is that you put him on hold, after you found out the name of his bank. You put him on hold. You tell him that within a minute or two someone from his bank will call him to get his permission to wire transfer those funds. And you say to him in a way so that it sounds legitimate: Mr. Schmidt, I don't want to know your number, your bank account number; it is none of our concern. I'll tell you what our account number is. I'll tell you the name of our bank.

And of course, you want to use the most impressive banks: the Chase Manhattan Bank, the Morgan Guarantee, et cetera, et cetera. But, Mr. Schmidt, you realize that you have to authorize this wire transfer, you've agreed to make this purchase.

And then what happens is, you put him on hold, and you, the broker, get on the phone and call his bank. And you tell him, the wire transfer person at his bank, that you are instructing his bank to wire to our bank in New York City \$3,500. You give that bank in Texas our account number. You tell that person at the bank in Texas that he should put you on hold now and that he should call Mr. Schmidt. And you ask him: do you have Mr. Schmidt's telephone number? In small banks in rural America many times they do, because it's a personal contact. Even if he does, you volunteer to give that number, again to establish a sense of legitimacy. Then the clerk calls Mr. Schmidt, who is now still on hold, asks Mr. Schmidt: do you want to wire this money? I have instructions from the comptroller of a securities firm in New York; all I need is your verbal permission.

By that time Mr. Schmidt is probably so confused and feels that he's trapped into this thing, even though he wants to realize a profit, he has allowed himself to get caught up in the quagmire; and he gives his OK. The money is instantly transferred to our account in New York.

Almost 50 percent of whatever funds that are transferred go to the salesman who has made that call. Now, a reputable commodities

firms registered on the commodity exchange would have placed an order for this amount on the floor of the exchange. But we did not trade on any commodity exchanges. Initially we bought a contract from a wholesaler.

Mr. SIKORSKI. Without getting into the specifics of this, basically what happened to your people is that—if the price goes up dramatically, they get some profit. If it doesn't go up dramatically, there's a wash. You get at least around half of what they paid in as commissions, or your sales people do.

Mr. X. Well, this is——

Mr. SIKORSKI. You protected yourself and these people by investing in another broker. It turned out that broker was flimflamming, and you went under. You got visited by the Postal Service?

Mr. X. That's correct.

Mr. SIKORSKI. Whereupon you got miked, you wore a body mike, as I understand it.

Mr. X. That's correct.

Mr. SIKORSKI. And you went on 27 different visits to this wholesaler broker.

Mr. X. That's correct.

Mr. SIKORSKI. And what happened then?

Mr. X. Well, as it turned out, initially when I got involved, I did not—when I got involved as an owner of a company and I started my own company, I was not going into it with the idea of not having contracts to back up the contracts that I was selling. I was one of the few companies in Wall Street at that time that did make an effort to back up these contracts.

Mr. SIKORSKI. Your only questionable activity was taking——

Mr. X. Is the sales techniques and allowing my people to exaggerate, lie, high pressure techniques, et cetera, et cetera; that's my crime.

Mr. SIKORSKI. And to take this big commission.

Mr. X. Correct.

Mr. SIKORSKI. But if the gold had kept going up, as it was going up at that time, there still would have been a pretty sizable profit accruing to these customers.

Mr. X. That's exactly when the whole thing came down.

Mr. SIKORSKI. You got taken——

Mr. X. I got taken, as I was taking the public.

The firm that I was backing my contracts with, for the record, it was determined that there was close to 100 million dollars' worth of funds owed by this firm to firms such as my own and others in this scam business, none of which, to my knowledge, was ever recovered or ever sent back to the firms. My firm took in from the public \$2.2 or \$2.3 million. I was a small fish. Of the \$2.2 or \$2.3 million that my firms took in, a little over \$100,000, \$115,000 or \$120,000, was returned to the public.

Mr. SIKORSKI. You had 300 customers in 41 States.

Mr. X. That's correct.

Mr. SIKORSKI. You took in this \$2.3 million or so, and you paid out only \$115,000 or so. Most of the people lost their entire investment.

Mr. X. Most of the people did.

Mr. SIKORSKI. Your activities on behalf of the Postal Service and the investigators led to the principals of this wholesale broker that you dealt with and who told you to backdate contracts, help them hide assets, as well as cover up other crimes which they had committed. Your work led to several of these people being convicted for mail fraud, perjury, obstruction of justice, and wire fraud, leading to 10-year sentences.

Mr. X. That's correct.

Mr. SIKORSKI. What happened to the sales people?

Mr. X. That's an interesting question, because when I went to jail, and even a couple of years before I knew that I actually had my date with the jailer, I decided that I wanted to try and right the wrong. And although I did not get personally involved with the sales people that worked with me, even when I owned my own company, I was interested in following some of their careers. I found that most of the brighter sales people that worked for me, as soon as I was shut down, within a matter of days, started their own companies and hired other sales people that worked for me and/or went through the traditional way of putting ads in the paper and guaranteeing \$1,000-plus per week commissions on telephone sales, et cetera, et cetera.

It also became very interesting to me because I had spoken to some of these people during this period of time, and I had warned them, having knowledge of what the postal authorities were going to be doing to some of these people if they furthered these activities. I had warned them as best that I could without telling what was going on, to get out of this business: I am taking the fall. You fellows get out. Go back and do whatever you used to do, a legitimate type of business.

Mr. Chairman, the money is so great that these people are willing to take a chance of going to jail. And they stayed in it.

I have a conversation with—

Mr. SIKORSKI. The sales people don't get prosecuted, by and large.

Mr. X. The sales people up to that point in time, we're talking about 1981, 1982, from my knowledge, there were very few that were ever prosecuted. It was usually the owners of the companies or the comptrollers of the companies that were prosecuted. And even at that point many of them didn't really go to jail for very long periods of time. A lot of them got slaps on the wrist and were let go. And that's the problem. The salesmen knew this.

We had people that were far brighter than I was, that should have been in my position as an owner but decided for their own well-being not to become an owner because they knew that the owners were going to go to jail and not the sales people.

Mr. SIKORSKI. And some of them in your operation made a lot more money than you did?

Mr. X. There's no question about it. There was one man that—well, there were two or three, but one comes to mind in particular, who made an average of \$8,000 to \$10,000 per week commissions.

Mr. SIKORSKI. You have told us a lot, and we've got some other witnesses who want to get on. You have told us that there are some things that can be done in terms of bonding and licensing on a local level. You have also told us that telephone company is a major part of this, in fact a critical part of this process. We can

look at some changes there. Do you think we should have stiffer penalties requiring disclosure statements, especially looking at off-shore holding companies that are really held by onshore American companies, allowing some kind of cooling-off period and requiring financial statements be available?

Mr. X. I believe that the postal authorities in conjunction with the FBI, in conjunction, of course, with the U.S. attorney's office, and many State and local authorities, are doing the best that they can at this point.

Mr. SIKORSKI. In fact, the Postal Service scares them, doesn't it? The FBI—

Mr. X. Well, the FBI scares them more than anyone. The FBI scares them because many of these people have records. Many of these people have been in jail either on a State level or a Federal level before. It's a certain type of a personality that can stay in this kind of business. And those types of personalities, from my experience, are people that have been in trouble with the law before. They have a formula, the risk-reward ratio. The risk is they're going to go to jail for 2 or 3 years. The reward could be hundreds of thousands of dollars, if not millions of dollars, in their own pocket. They realize that, even if they do get caught, for the most part they're not going to lose the money that they have bilked from the public, because they're going to put it into legitimate establishments, houses, et cetera, et cetera, et cetera. That's a major problem, I think. I don't think that the country—

Mr. SIKORSKI. They divide the amount of money they can make by the number of years that they potentially spend in prison—and only a small fraction ever get caught and eventually convicted—and they figure that the risk, the cost-benefit analysis is decidedly in their direction.

Mr. X. There's no question about it. You will find that a lot of these people are also gamblers, and this is a gamble. They realize this. Those that have been in the business for any period of time, they realize this. They know that they're not going to lose their houses. They know they're not going to lose their boats and their other business establishments where they filter their money through. It's almost like a laundering situation.

The banks are at great fault, great, great fault. I can recall the day that the postal authorities came into my company with a warrant to shut down the company. Immediately I went to the bank and withdrew \$140,000, without a question of the bat of an eye from the bank. The banks are at great fault. They allow these moneys to come in, wire transfer from Minnesota, from Texas, from all over the country into New York. And as soon as that money comes in, almost the same day it goes back out to somebody's account.

The salesmen get paid immediately. There is never a large floating amount within any one of these kinds of companies' accounts.

Mr. SIKORSKI. So, when you get done with the whole prosecution, there's very little there to pay back the victims and very little to find for restitution purposes.

I want to get to the comptroller of Florida here. He has an FBI tape that shows this boilerroom operation in operation that will be

helpful to explain some of these people and how they operate and the rest of it.

But you're in good shape now? You're in business and working?

Mr. X. Yes. I finished my jail sentence. I finished my parole. I've been off parole for 2 years. I was only once in my life ever in trouble, and it was because of this situation. I am working for a major firm in New York. I deal with Fortune 500 accounts. I am back into the type of professional sales that I had spent 17 years in before I was lured into the fast buck. I think that this certainly has taught me a lesson. It practically destroyed, if not destroyed, my family life, which is probably good payment for what I allowed to happen and what I did myself.

I think that we should, we the American public, should realize that there are hundreds and hundreds of millions of dollars being bilked on a daily basis across the country. I am not sure whether we are ever really going to be able to stop it all, but, I think, through hearings like this and efforts on good people that we can certainly take a good stab at it.

Mr. SIKORSKI. You're doing your part.

Mr. X. I'm here to try to do my part.

Mr. SIKORSKI. The subcommittee thanks you for your willingness, the Congress thanks you, for your willingness to keep on this issue and keep the education going, the information flowing, and pushing the legislation that can help chip at this issue.

Once again, thank you very much.

Mr. X. Thank you.

Mr. SIKORSKI. It will take just a few minutes to rearrange things.

But maybe Mr. Lewis can come up. As we're doing that, again the subcommittee wishes to thank you, Comptroller Lewis, and commend you for the excellent job you have been doing in Florida to slow down these criminals. Your experience with Florida's legislation and your enforcement activities before and after the legislation are invaluable to us in trying to fashion more effective Federal initiatives to address this nationwide problem. Again I want to thank you for your patience as we go through this process of trying to fit a hearing in on a busy schedule.

Do you have any objection to being sworn in?

Mr. LEWIS. No, Mr. Chairman.

Mr. SIKORSKI. Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. LEWIS. I do.

Mr. SIKORSKI. Great. We thank you. You have some very helpful testimony. We would like you to begin with that. You can introduce the video that we have.

TESTIMONY OF HON. GERALD LEWIS, COMPTROLLER OF FLORIDA AND HEAD OF THE FLORIDA DEPARTMENT OF BANKING AND FINANCE, ACCOMPANIED BY MICHAEL UNDERWOOD, ASSISTANT GENERAL COUNSEL, OFFICE OF THE COMPTROLLER

Mr. LEWIS. Thank you, Mr. Chairman.

I would like first to introduce, if I may, our assistant general counsel, Mr. Michael Underwood. You may have some questions.

Mr. SIKORSKI. We welcome you as well.

Mr. LEWIS. First I would like to echo some of the comments that have been made commending you, Mr. Chairman, and your subcommittee on undertaking this series of hearings and, hopefully, congressional action, because this is a major problem. It has been a major problem to us in Florida and obviously around the country.

Let me explain that, as comptroller of Florida, I am the head of the department of banking and finance. Within that department, I have the authority and responsibility of regulating the securities industry. That's what brings us into the boilerroom operation, especially as it applies to the sale of investments and the investment fraud that comes from that.

I appreciate the opportunity to appear here. As I listened to some of the other testimony, I realized I may be repetitious; but let me just say that boilerroom is a generic term used to describe offices equipped with batteries of telephones, often WATS lines that operate across State lines. These boilerrooms are used by unscrupulous sales personnel to sell an endless variety of products using high pressure telephone solicitation techniques. We in Florida are especially sensitive to this because we seem to attract our share of conmen in boilerrooms and other types of fraud. Our climate, the fact that our population is growing so rapidly with new people coming in, with the money that brings, a good climate—with no disrespect to our great sister State of California, I was happy to hear you say that south California has the reputation of being the fraud capital of the world. We have been fighting that designation for some time now.

Florida also has a geographic location close to the offshore islands and the banks there that offer conmen the ability to move the money out of the country quickly and secret it, then bring it back in through wire transfers and other methods.

We also find that the number of boilerrooms tends to increase geometrically. As you pursue one, as you prosecute one, the salespeople tend to branch out and go into business for themselves, creating numerous other boilerrooms.

Mr. SIKORSKI. It's kind of a pyramid process.

Mr. LEWIS. Yes, sir, exactly.

In the cynical jargon of this industry, customers are called mooches, telephone solicitors are called yaks. The yaks, as Mr. X testified, frequently have criminal records and almost always use aliases to conceal their true identity.

Initial telephone contact may be the result of what is called a cold canvass or from a list obtained anywhere. It may come from a lead card or a sucker list, which is a list purchased, or it may even be stolen from another boilerroom. This call is referred to as the pitch and is then followed up by a slick brochure. A few days later, the potential customer will receive the drive call, typically stressing the need for immediate action, again as you've heard today.

Some solicitors actually do exercises before calling in order to be out of breath on the telephone. Others get hyped up through the use of drugs.

Prepared text, called objection sheets, contain persuasive arguments when a victim says: well, I need to consult with a lawyer or an accountant, telling them why they shouldn't do this and why

they need to invest immediately. Husbands that say I want to discuss my investment or my purchase with my wife, are asked: who wears the pants in your family?

Mr. SIKORSKI. I saw one objection list that had someone saying: this seems too good to be true. The response is: it is good, it's very good, and it is true—which I'll start using door to door when I go around. But it's an amazing operation. These objection lists I am sure are from testing hundreds of thousands, millions of phone calls. They can design a response to virtually any objection that is given on the phone.

Mr. LEWIS. Every imaginable misrepresentation is made to persuade the victim to send money. As you have heard, personal checks are discouraged. Wire transfer instructions are given; again, you've heard detail on that. In some cases, the boilerroom arranges for a courier to come to the customer's home to pick up cash.

Mr. SIKORSKI. Even across the country, they have these courier services. They call them up, and they'll go and pick them up.

Mr. LEWIS. Yes, sir.

Once a victim gets involved and pays, another call will be made, usually from a new solicitor called a loader. This is often the owner or manager of the boilerroom. The purpose of the load call is to see if the victim will invest more money. Again, you heard one example of that already. We saw that type of thing in the sale of interest in phony oil wells. In that case the boilerrooms were actually operating out of Texas and Oklahoma. Our State and many others contained the victims. But once they had someone on the hook who had invested, they would then call and say: this is going so well, this exploration, we want to let you in on another oilfield adjoining this. And we are only going to let a few people in on this, but because you have been so faithful we're going to give you the opportunity.

If the person resists, very often they will refer the victim to someone who has allegedly achieved great results through the program. Usually that person is what is called a singer, a person who has been employed to give a phony testimonial in exchange for payment. In one case we're not very proud of in Florida the president of the Miami Better Business Bureau was actually corrupted to conceal complaints about a boilerroom. He was convicted of that crime.

In 1983 my office began a coordinated crackdown on investment fraud from boilerrooms in Florida. Since then we have civilly prosecuted over 100 boilerrooms and over 600 associated individuals. Indictments and informations have been issued against nearly 200 of these people.

In 1984 the Florida Legislature made it a felony to operate a boilerroom in Florida for the perpetration of fraud in connection with the sale of securities, commodities, or other investments. Passage of this law caused several operations to immediately relocate outside of Florida.

Also in 1984, we created the Fort Lauderdale Information Pointer System, or FLIPS. This is a permanent cooperative effort of 15 State and Federal agencies, including the Postal Inspection Service, the FBI, the U.S. Attorney for the Southern District of Florida, and others, to share information on boilerroom activity in south Flori-

da. This is based on a system for identifying traffickers of narcotics. It is an index maintained in our Fort Lauderdale office pointing—is the reason for the term pointer—to that agency which possesses information on a particular company or individual. At the present time, there are over 15,000 entries in the system. If we can claim any success in our fight against boilerrooms—and we believe there has been a substantial reduction in the number of these operations in Florida—we think it's due to this type of cooperative effort between Federal agencies and State agencies using this kind of advanced computer technology.

I would like to give special credit to the Postal Inspection Service in south Florida for its cooperation with our office and other law enforcement agencies. At the risk of leaving anybody out, there are a few people that have worked closely with us: Mr. Bob Carroll, Mr. Paul Feltman, and Mr. Ron Williams, together with other postal inspectors who we think have done a great job.

But the problem of boilerroom fraud is still with us. I have recently, because of boilerroom fraud and other investment fraud in Florida, created a special task force on securities regulation. Former Governor of Florida, Reuben Askew, has agreed to serve as chairman of the task force. They have been meeting, will be meeting from now until the legislative session which convenes in April of next year. They are considering broad proposals, again, on securities regulation but including boilerrooms. They will be looking at possible broadening of the definition of a criminal boilerroom.

Mr. SIKORSKI. To bring in the kind of scams that appear to be increasing, in advertising products, and boats, and things like that. They aren't included. This kind of thing wouldn't be stopped under the new 84?

Mr. LEWIS. No.

Mr. SIKORSKI. It would not.

Mr. LEWIS. The jurisdiction of our office is pretty generally limited to securities. The statute that was enacted by the Florida Legislature, as a matter of fact there is some pretty intensive lobbying, as you might imagine, that forced us to compromise on the bill. But even under the bill that we had, we talked about personal property that involved return on investment, as opposed to the direct sale of such things as the boat and these items.

But California is going to soon require the registration of all telephone solicitors.

Mr. SIKORSKI. January 1, as I understand it.

Mr. LEWIS. That's correct.

And that is something that I am sure our task force and perhaps the legislature will look at, though, in all candor, I am not sure that—it's something I would want to consider a lot more. You know, there's really no secret, I suppose we could pass laws that would absolutely prevent any of this activity. But in the free market there's a balance that always has to be made. There are legitimate telephone solicitations, and somehow there has got to be that balance.

Mr. SIKORSKI. I think registration just provides some source of information if people want to check up, also, probably more importantly from a prosecution standpoint, it can be one more violation that triggers the investigation and the enforcement process.

Mr. LEWIS. I would agree with that, Mr. Chairman. My experience has been, for example, in securities fraud. Florida has a very tough law that makes it a felony to sell an unregistered security or for the person to be unregistered himself or herself as a securities dealer. We found as a practical matter it's very difficult to get a conviction unless there is fraud. You have to have that witness that has lost his or her life's savings. When you have the fraud, then you have the other counts that give the judge the leeway to hand out a very stiff sentence.

I would respectfully suggest that Congress can help by recognizing, as you already have, that boiler room activity is a national problem. It makes no difference to the victim whether the telephone calls originated in Florida or California or New York. Prosecutions for violations of Federal mail and wire fraud should be made a priority for U.S. attorneys. Again in Florida, we are fortunate. The U.S. attorneys that we have dealt with do take this very seriously. But it is a difficult, time-consuming type of prosecution. When you take into account the workload that U.S. attorneys, all prosecutors have with drugs and violent crimes, and so on, it's just one of those things that has to fit in somewhere.

We need to make effective use of the limited resources that we have. That, in my opinion, dictates cooperation whenever possible between State and Federal agencies. Joint enforcement actions have been taken by our office and the Commodity Futures Trading Commission, and we have had success with that. We have also worked closely with the Postal Inspection Service. There we have one legislative problem. We would urge you to consider an act to remove any existing limitations on the ability of the Postal Inspection Service to share information with State agencies. Such a limitation now exists in chapter 119 of title 18 of the United States Code dealing with interception of telephone communications.

Today the Postal Inspection Service and all other Federal agencies are prohibited from sharing with our office any information gathered under that chapter because agents of governmental entities having only civil enforcement authority, as we do, are excluded from the definition of, quote, "investigative or law enforcement officers," end quote. This prohibition, it seems to me, does not make sense if we are going to effectively prosecute this kind of fraud. Perhaps chapter 19 could be modified to permit disclosure in the manner permitted in the Privacy Act in 5 U.S.C. section 522A(b)(7). That section permits disclosure of certain specified records, and I quote:

To another agency or to an instrumentality of any governmental jurisdiction within or under the control of the United States or a civil or criminal law enforcement activity if the activity is authorized by law and if the head of the agency or instrumentality has made a written request to the agency which maintains the record specifying the particular portion desired and the law enforcement activity for which the record is sought.

End of quote.

I think that that kind of provision would permit the sharing of information and still have the existing safeguards to prevent improper disclosure.

I would agree with several of the previous witnesses that investment fraud and boilerroom fraud are increasing. It increases in our

State as the population increases. We have a large number of elderly citizens. We find our demographics are changing, though. More and more of the retirees that are moving to Florida are more affluent, which again becomes a more lucrative market for con men. Also, as deregulation of the financial services industry continues—and I might say one of my other hats is as banking commissioner—but the deregulation of the financial services industry makes possible a lot of investment type schemes that never existed just a few years ago.

Mr. SIKORSKI. Our Oversight and Investigations Subcommittee of Energy and Commerce on which I sit has been looking at that. That is a good example of very sophisticated investors for public entities like cities, States, and counties. Some of them in my district were in ESM. When they were done, they didn't lose because they got out before the fall. But what happened in Ohio is a ripple effect of what happened in that, basically a Ponzi scheme, use of phones and use of mails.

Mr. LEWIS. Finally, I find it difficult to argue with some of the testimony that perhaps public awareness and public education is not going to stamp out fraud. And I don't know the answer to that. I think we need to keep trying. I think that to the extent that public awareness, public service announcements may prevent even one person from being defrauded, they are valuable. I think we need to keep at it. But I would agree that that is not going to end it. Maybe nothing that any of us do is going to totally wipe out fraud. You have got the combination of greed and gullibility and human nature, and I suppose that's always going to be with us. I think we do need to keep working at it and keep trying to perfect our laws and public awareness, together with vigorous prosecution both civil and criminal.

Mr. SIKORSKI. The point that I am amazed with is that this has been around for years. There's a movie called the Flimflam Man. As Forbes pointed out, you had people selling penny stock back in the 1920's related to the crash. We had hearings in Congress, hearings in Florida and other States action. Yet, with all this, and the media attention, the public service announcements, and the rest, with all of this, apparently through the late 1970's and now through 1985, the thing is growing exponentially. Is that your experience as well? Although, you have a better handle on the prosecution aspects of it, do you see more and more people being affected by more of these operations and more money being lost in the process?

Mr. LEWIS. Yes, sir, I would have to agree with that. I don't want to keep you here all day, but there is story after story. We have been successful in a couple of cases in civil litigation in getting a consent order under which the defendant company agreed to return the money to all the investors. Routinely we find that a very, very small percentage of investors will take their money back, even though they know a lawsuit was filed alleging fraud, they ought to assume from the consent order that they might be better off. But they still cling to that hope of getting that 20 percent return or whatever it is.

Mr. SIKORSKI. There is ego involvement. There is belief in other people's good nature, human nature. And there is the concern

about making a good chunk of money. Those are the kinds of things that these operations prey on.

You have a very interesting piece of tape here. I think we are going to watch just a segment of it. Do you want to introduce it?

Mr. LEWIS. If I could, I have been asked to make a statement. The videotape that you are going to see has been provided as a public service by the NBC Television Network news division. It is for use as an educational and training aid, with the understanding that there will be no duplication or publication of the material.

The tape was made by an undercover agent employed with NBC to infiltrate a boilerroom in Los Angeles. The boilerroom was allegedly a franchise selling a deferred delivery of precious metals program from a company known as Wellington Precious Metals, whose headquarters is in Miami. The tape was made using a camera hidden in a bag that the NBC employee took in with him. A portion of the material we are about to see was used during a special segment broadcast by Tom Brokaw on the NBC Evening News.

Let me interject here that you will hear a telephone conversation with one victim. And on the NBC Evening News they later interview this woman. Her name is Margaret Kincaid from Louisiana. She is an elderly woman. She is blind in one eye, with an extremely thick lens in the other eye. In viewing the videotape here, she had to use a magnifying glass. It's a really pitiful situation. Yet, you will see in this tape these people make great fun of what they're doing.

Mr. SIKORSKI. This tape doesn't have the victim on it.

Mr. LEWIS. No.

Mr. SIKORSKI. But we have to understand, we have an elderly woman who is blind in one eye, almost blind in the other eye, who is on the other end of this phone being jockeyed around.

Mr. LEWIS. Yes, sir.

One final thing, there is some language on here, there is some offensive language that is used, but that's just part of what was going on.

Mr. SIKORSKI. Any language that is used is theirs and not ours.

Mr. LEWIS. Yes, sir.

Mr. SIKORSKI. And it helps pinpoint or depict the situation.

[Video presentation.]

Mr. SIKORSKI. I think we've seen enough.

This lady was bilked how much?

Mr. UNDERWOOD. She made an initial investment of \$2,000. This is the load call, where they tried to get an additional \$5,000.

Mr. SIKORSKI. What happened to these people?

Mr. LEWIS. We currently have a civil suit. In fact, there is a hearing set at 12:30 on a motion of ours for an injunction. We had hoped to have that dramatic information, Mr. Chairman.

Mr. SIKORSKI. An injunction to shut these people down?

Mr. LEWIS. Yes, sir.

Mr. SIKORSKI. They are not shut down now?

Mr. UNDERWOOD. This operation is in California.

Mr. SIKORSKI. This operation was in California, but it's a part of—

Mr. LEWIS. The headquarters is in Miami.

Mr. SIKORSKI. It's a damning tape, but we have to remember it's only one little picture of a multi-billion-dollar problem involving deceit and greed that is preying on everyone from the very sophisticated and formal to the very unsophisticated and informal in our country.

Congressman Pepper has recommended, as the Postal Service will talk to in just a second, a strengthening of the felony punishment in this kind of situation and of allowing for forfeiture, seizure of property so that they can take whatever is there and provide some restitution to the victim.

You mentioned three things that are important for us to do, other things that States can do. One is to set up cooperative kinds of discussions, even informal ones, between the Federal and the local law enforcement people. Second is sharing information, especially making that statutory change that allows you to get into this information that is already on computer on file. Third, you have recommended that we make a priority of this kind of prosecution to serve notice that we take this white-collar crime seriously.

The postal department will now talk about c.o.d. changes as well.

Do you have anything you want to add?

Mr. LEWIS. No, sir. I again thank you and commend you on your efforts and wish you good luck.

Mr. SIKORSKI. The subcommittee wants to congratulate you and your office for doing an excellent job, and the people that you have singled out for assisting in this effort. If we can be of more help, you have given us some direction, and we will try to live up to the responsibility we have to follow up. If you see anything else we can do, we stand ready to help.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. SIKORSKI. Thank you.

Our next panel are two gentlemen from the Postal Service. We have the Assistant Chief Postal Inspector, Jack Swagerty, and Donald Dillman, Director of the Office of Mail Classification.

Do either of you have objection to being sworn in?

Mr. SWAGERTY. No.

Mr. DILLMAN. No.

Mr. SIKORSKI. Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. SWAGERTY. I do.

Mr. DILLMAN. I do.

Mr. SIKORSKI. I welcome both of you gentlemen. Thank you for your testimony today and your assistance in putting together this hearing. But we feel that more can be done to close down these boilerroom operations. We recognize that your task as representatives of the Postal Service is not an easy one. I hope that by working together we can develop additional safeguards to protect the American consumers from these kinds of ripoffs.

Both of you have statements. I am going to ask that, with the hour being what it is, that you do your best to—both of your entire statements will be printed as you like them in the record. They have been handed out. So, if you can summarize, that would help us. But I don't want to leave anything out. It's up to you.

Mr. SWAGERTY. I will give a quick summary.

Mr. SIKORSKI. Good.

TESTIMONY OF JACK E. SWAGERTY, ASSISTANT CHIEF POSTAL INSPECTOR, U.S. POSTAL INSPECTION SERVICE; AND DONALD D. DILLMAN, DIRECTOR, OFFICE OF MAIL CLASSIFICATION, RATES AND CLASSIFICATION DEPARTMENT, U.S. POSTAL SERVICE

Mr. SWAGERTY. Mr. Chairman, first of all, I would like to thank you for this opportunity to appear before you today. What you are doing is very important, and we support and applaud your efforts.

Telemarketing sales in this country is a thriving, multimillion dollar growth industry in which the vast majority of sales representatives conduct their business in an honest and forthright manner. Fraudulent activity, which we will be talking about today, is caused by a small segment of the marketplace which has grossly misused its talent and expertise to the detriment of the telemarketing industry and the American public. For the past decade, the proliferation of boilerroom fraud activity in the United States has grown to huge proportions. Boilerroom solicitors pitch anything and everything ranging from oil and gas leases and other investment opportunities to office supplies, charitable solicitations, and a limitless array of marketable merchandise.

Depending on the economic and social times, the boilerroom promoters will vary their pitch and the nature of the product they are selling. Early in the 1970's, the telephone solicitors found a haven in the selling of advertising space in nonexistent national minority publications. Boilerroom operators then took advantage of hard economic times for smaller businesses who often do not have an advertising budget. They began conning business owners into purchasing ad specialty items such as advertising pens, key tags, ice scrapers, and so on.

In the late 1970's and early 1980's, with interest rates soaring and money in short supply, boilerroom solicitors began offering a myriad of investment opportunities such as speculation in gold and silver, securities, commodity futures, real estate, and oil and gas leases to the unwary public.

More recently, the telemarketing trend has primarily shifted boilerroom merchandise schemes to targeting both small businesses and individual customers.

I would like to tell you about some of the things that we are doing to prevent this activity. As with all of our enforcement areas, we feel that strong and vigorous prevention programs are the key to a successful resolution of the problem.

In an effort to heighten public awareness to mail fraud and other postal offenses, we have selected and trained over 100 postal inspectors across the country as crime prevention specialists. Working with other Federal and State agencies and consumer groups, one of their missions is to educate and inform the public. They work with the media, and last year appeared on over 1,000 local television or radio interview programs, conducted over 900 newspaper and magazine interviews, and appeared before approximately 2,600 consumer and business organizations. Also, more than 400

news releases were issued reporting on the results of mail fraud and other types of investigations.

As part of our boilerroom fraud prevention program, public service announcements have been developed and aired over 3,000 times—that's in this past year—by network, local, and cable radio and TV stations. Taped segments have aired on the David Horowitz Show, ABC's 20-20, CBS' 60 Minutes, and on local newscasts like Neil Murray's series. These efforts have helped significantly in alerting the general public to this activity. Also, Inspection Service-initiated prevention messages have appeared in chamber of commerce, better business bureau, trade, law enforcement, and other publications nationwide.

One type of fraud of particular concern to the Postal Service is the COD boilerroom fraud. This type of scheme is especially erosive to public confidence in the mails because the mail system is actually used by the fraudulent operator to enable him to carry out the scam and collect the money.

I would like to give you some specific examples of what we are doing to prevent this type of COD boilerroom fraud. We mail out 15,000 letters each month to businesses that have 25 or fewer employees warning them about these schemes. We have publications carrying our prevention messages that are available at post offices throughout the country and we also distribute them at postal forums and consumer fairs.

Mr. SIKORSKI. Jack, before you go on, I think you skipped a point that should be made. You identified a profile of the type of victim businesses. It's 25 employees or less, new businesses?

Mr. SWAGERTY. New businesses, 25 employees; yes. That is a profile we developed.

Mr. SIKORSKI. And that's who you have been targeting for your public education.

Mr. SWAGERTY. Yes, sir, that's correct.

Another thing that we did recently in, I believe, the State of Alabama was alert a number of businesses to this kind of scheme. I think we contacted every business in the city of Birmingham. And we took a followup survey on that. We found that those businesses turned back approximately 1,400 COD parcels. We believe we may have saved them in the neighborhood of \$175,000.

Mr. SIKORSKI. This is incredible. In the fall of 1984 in Birmingham, AL, one locality, you sent out to small businesses, you notified all small businesses of the problems regarding COD boilerroom fraud. In the spring you found out in that time period 1,400 parcels averaging \$125 each were refused by the postal customers as a direct result of your warning notice. In just, say, 6 months you got 1,400 parcels that were refused, at a cost of \$125. I presume some of them would have been refused anyway, but the bulk of those are a response to your program.

That is amazing.

Mr. SWAGERTY. Right.

Mr. SIKORSKI. I couldn't believe that 1,400 small businesses in one locality—I don't think the Birmingham, AL metro area is bigger than a million people, is it? I can't believe that 1,400 of them were refused. God knows how many accepted them.

Mr. SWAGERTY. Right, 1,400 parcels. And as a result of that we are very encouraged by those efforts. We are now working with a marketing firm to develop a good nationwide message to these kinds of businesses. We think that too will be successful, but we are relying on the expertise of a marketing firm to help us develop that message.

Mr. SIKORSKI. Good.

Mr. SWAGERTY. In addition to these prevention efforts, we are also pursuing a very vigorous enforcement program against these boilerroom fraud schemes. We rely heavily upon a civil remedy through which we can obtain consent agreements and mail stop and cease-and-desist orders. This promptly protects the public from being victimized by ordering the return of the money to the sender and thus depriving the promoter of the proceeds from the scheme.

The Criminal Mail Fraud Statute provides for a fine of \$1,000 and imprisonment of up to 5 years for intentionally devising a scheme to defraud using the U.S. mails. In March of this year, H.R. 1581 was introduced by Congressman Pepper to increase the maximum penalties to \$10,000 and 15 years imprisonment.

Mr. SIKORSKI. And you support that?

Mr. SWAGERTY. Absolutely.

Mr. Pepper's bill also includes civil and criminal forfeiture provisions which would allow the Postal Service to seize the fraudulent promoter's assets and provide restitution to the victims.

I fully support this. This is going to be one of the big keys to putting these companies out of business. The gentleman who had been convicted this morning said, I think, that he withdrew \$140,000 from the bank on the day that we served the search warrant. This would allow us to seize the assets and really hurt these people where we should be hurting them.

Mr. SIKORSKI. Good. Maybe this hearing can give some impetus to that legislation.

Mr. SWAGERTY. Yes, sir, I hope so. Thank you.

Currently our only prospect for getting relief for victims is to hope that restitution is ordered by a Federal judge during the sentencing process of the con artist.

I would like to go into a couple of cases to demonstrate the magnitude and diversity of this kind of scheme. I will be brief.

On April 9 of this year, 18 individuals received sentences of up to 20 years for their participation in Florida-based boilerroom oil and gas investment sales operations. The subjects had been found guilty on mail fraud and conspiracy charges in connection with the operation of U.S. Oil and Gas Corp., Stratford, and Eagle Oil and Gas. Investigations spanned 3 years and culminated in a 14-week trial. There were approximately 10,000 victims, and we think the loss was somewhere in the neighborhood of \$56 million.

I put that in just to point out the magnitude and sometimes the difficulty in investigating these cases.

Mr. SIKORSKI. 10,000 victims, \$56 million that you can identify.

Mr. SWAGERTY. Yes, sir, that we're aware of.

Mr. SIKORSKI. How long had they been in operation?

Mr. SWAGERTY. I am not sure. I could get you that information.

Mr. SIKORSKI. Thank you.

Mr. SWAGERTY. On June 29, 1984, a temporary restraining order was issued by a U.S. district court judge against Continental Pen, Inc., and U.S. Premium Products, Inc., at St. Paul, MN, and the principals in both firms, John and Barbara Farkas. Continental Pen sold advertising specialty items through telephone solicitations throughout the country. Purchasers were first contacted over the telephone or by certified mail and advised that they were one of 101 winners selected to receive a fishing boat. Individuals then received a letter from U.S. Premium Products advising them that in order to receive the boat, they had to pay a \$62 redemption fee.

On September 4, 1984, the Postal Service filed a cease-and-desist order against the company and its principals. A Federal search warrant was issued and executed, which effectively closed down the promotion of Continental Pen and U.S. Premium Products.

At the time of the search, we did seize \$15,000 in cash and \$60,000 in uncashed checks. We recovered these and returned them to the intended victims.

It is estimated that approximately 10,000 individuals were victimized in these scheme, resulting in about a \$2 million loss.

Mr. SIKORSKI. This is 10,000 hits and a \$2 million loss out of this St. Paul company?

Mr. SWAGERTY. Yes, sir, that is correct.

I am going to close this brief statement now, but I would like to emphasize that we think the key ingredients in any effort to curb fraudulent boilerroom activity are to increase public awareness of the problem and maintain our vigorous enforcement effort. Of course, there are many other things. Certainly I like Mr. Murray's efforts. We applaud the State of Florida. All of those kinds of things will help. But we believe that public awareness and education are a very important part of this.

I would be happy to answer questions you have now, or we can go on to Mr. Dillman's statement.

[Statement of Jack E. Swagerty follows:]

STATEMENT OF JACK E. SWAGERTY
ASSISTANT CHIEF POSTAL INSPECTOR
UNITED STATES POSTAL INSPECTION SERVICE
BEFORE THE INVESTIGATIONS SUBCOMMITTEE
OF THE HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE
NOVEMBER 14, 1985

Mr. Chairman:

My name is Jack Swagerty, Assistant Chief Postal Inspector for Criminal Investigations. I appreciate the opportunity to appear before this Subcommittee to discuss our efforts to prevent and curb collect on delivery (COD) and other boiler room fraud schemes.

The Postal Inspection Service is the law enforcement arm of the Postal Service, tracing its origin to the year 1772, thus making it one of the oldest law enforcement and investigative agencies of the federal government. Postal Inspectors have statutory authority to serve U.S. warrants and subpoenas and to make arrests for postal related offenses.

The postal crimes with which the Inspection Service must contend fall into two broad categories: (1) those actions which involve a criminal attack against the Postal Service or its employees; and (2) those which involve criminal misuse of the postal system itself. Investigative responsibilities include mail theft, burglary of post offices,

robberies and assaults on our employees, pornography and bombs sent through the mails and mail fraud. The magnitude of these responsibilities is in direct proportion to the size of the Postal Service itself which in Fiscal Year 1984 handled over 131 billion pieces of mail, had over 700,000 employees, over 39,000 postal facilities and revenue of about \$25 billion.

The Inspection Service also has responsibility for internal audit in the Postal Service and for providing for security of postal facilities and employees. To meet our audit and investigative responsibilities, we have about 1,850 Postal Inspectors, and a uniformed Security Force of approximately 1,900.

We accomplish our law enforcement mission by working closely with the Department of Justice and their United States Attorneys across the country, as well as state and local law enforcement and consumer groups. With that brief introduction, I will now move on to the topic of today's hearing.

Telemarketing sales in this country is a thriving multi-million dollar growth industry in which the vast majority of sales representatives conduct their business in an honest and forthright manner. The fraudulent activity we will be talking about today is caused by a small segment of telemarketing veterans who have grossly misused their talent and expertise to the detriment of the telemarketing industry and the American public.

Boiler room fraud - it starts with a voice on the telephone convincing, sympathetic, sincere. Victims number in the tens of thousands and their losses surpass hundreds of millions of dollars. People may get "pitched" from Los Angeles, Dallas, Houston, Las Vegas, New York City, Phoenix, or any other city. Their victims are usually located away from the locale of the operation.

For the past decade, the proliferation of boiler room fraud activity in the United States has grown to near epidemic proportions. Boiler room solicitors pitch anything and everything, ranging from oil and gas leases and other investment opportunities to office supplies, charity solicitations, and a limitless array of other marketable merchandise items such as boats, televisions, motorcycles and computers. Depending on the economic and social times, the boiler room promoters will vary their pitch and the nature of the product they are selling. Early in the seventies, the telephone solicitors found a haven in selling advertising space in allegedly minority-owned publications. Legitimate businesses wanted to demonstrate their support for the minority business community and to document this support. Based on this new trend, the solicitors found it easy to exploit the needs of the minority community and businesses by the establishment of non-existent national "minority publications."

Being good con artists, the next phase for the boiler room operators was the exploitation of the hard economic times of smaller businesses. Small businesses normally do not have an advertising budget; however, they have an ever growing need to advertise their products and

services and are constantly looking for a means to do so. This is where the fraudulent telephone solicitors again struck it rich. The friendly salesperson tells the business owner that he is guaranteed to have won a fabulous prize. However, there is one slight consideration. The business owner is required to purchase a small amount of ad specialty items such as advertising pens, key tags, ice scrapers, sponges, baseball caps, and the list of items goes on.

In the late seventies and early eighties, with interest rates soaring and money in short supply, many people began to look for ways to invest their money in investments promising high returns. The boiler room solicitors were there to fill the need by offering a myriad of investment opportunities such as speculation in gold and silver, securities, commodity futures, real estate and oil and gas leases.

More recently, the telemarketing trend has primarily shifted boiler room merchandise schemes to targeting both small businesses and individual consumers.

Let me take a moment to describe how a typical boiler room operates. Setting up a boiler room is cheap and simple. All it takes are desks, file cabinets and banks of telephones. Sales personnel work hours on the phones and average \$30,000 a year in commissions. Top salespeople may take home \$3,000 a week plus bonuses. Fast talk and extremely high sales pressure are the keys to success.

Inside the boiler room, sales people, crammed into close quarters, yell and cajole over the phone. Music is often blaring. Bells ring when sales are made. An office manager jumps up and down, waving dollar bills and pushing promotional contests. None of this uproar, however, is audible to the customer. Noise is electronically filtered from the phone lines by devices insiders call "Confidencers."

The companies begin with prospect files, sometimes purchased, sometimes derived from business directories. Solicitors start with the "front speech," designed to fan curiosity, interest and greed. Prospects who seem "hot" are "papered" - sent a sales brochure often replete with exaggerations and misrepresentations. Next comes a "follow-up" call, usually a week or so after the front call. This is usually the time for the "drive," use of a carefully prepared script crafted to overcome resistance and pressure the sale. With a tough prospect on the line, the room managers will sometimes do a "takeover," breaking in on the line and making a stronger pitch. Managers usually monitor calls and, over a circuit closed to the customer, instruct solicitors on what to say during conversations.

Last come the "close," designed to get the check in the mail. The telephone solicitors utilized specialized scripts created to meet and overcome virtually any argument posed by victims. If victims ask to speak to satisfied customers, the solicitor readily provides the names and numbers of "singers" -- persons in collusion with the scheme, who will give glowing accounts of the firm.

Often the best customers are repeat sales. Solicitors regularly call back prospects with new and special offers. This is known as "loading."

When a boiler room nears its breaking point, the telephone salespeople make "drop" calls, offering discounts and premiums such as free trips. Then comes the "bust out." The owners leave town or perhaps just move down the block, open under a new name and start up the scam all over again.

Perhaps this pattern is the most insidious aspect of boiler room fraud -- the ease and facility with which owners and sales people intermingle and move on to other boiler rooms. After a "bust-out," or after law enforcement action such as civil cease-and-desist orders or even criminal indictment, boiler room operators go right back into business, at other boiler rooms or under another company name.

I would like to tell you what the Inspection Service is doing to prevent this activity. As with all of our enforcement areas, we feel that strong and vigorous prevention programs are the key to a successful resolution of the problem.

In an effort to heighten public awareness to mail fraud and other postal offenses, we have selected and trained over 100 Postal Inspectors across the country as crime prevention specialists. Working with other federal and state agencies and consumer groups, one of their missions is to educate and inform the public. They work with

the media and last year appeared on over 1,000 local television and radio interview programs, conducted over 900 newspaper and magazine interviews, and appeared before approximately 2,600 consumer and business organizations. Also, 414 news releases were issued reporting on the results of major mail fraud and mail theft investigations.

As part of our boiler room fraud prevention program, public service announcements have been developed and aired over 3,000 times by network, local and cable radio and TV stations. Taped segments have aired on the David Horowitz Show, ABC's 20-20, CBS' 60 Minutes and on local newscasts like Neil Murray's series. These efforts have significantly helped in alerting the general public to this activity. Also, Inspection Service-initiated prevention messages have appeared in the Chamber of Commerce, Better Business Bureau, Trade Journals, Law Enforcement and other publications nationwide.

As you will see from the case examples later in my testimony, there are many different types of schemes conducted by boiler rooms but one that is of particular concern to the Postal Service is the COD boiler room fraud, which is usually aimed at small businesses. In this scheme, the victim is offered what appears to be "high quality" merchandise which is sent COD. When the COD parcel is received it is either empty or it contains, "junk," but because the COD charges have already been paid, the customer has little recourse in getting his money back. This type of scheme is especially corrosive to public confidence in the mails because the mail system is actually used by

the fraudulent operator to enable him to carry out the scam and collect the money.

Let me give you some examples of what we are doing to prevent COD boiler room fraud:

- 1) Commencing in 1984, the Inspection Service identified a profile of victim businesses consisting of new businesses with 25 employees or less and generally merchandise or service orientated companies. We mail approximately 15,000 letters each month to small businesses nationwide warning them of the perils of boiler room fraud schemes.
- 2) Publications are available at post offices throughout the country and distributed at postal forums, consumer fairs, and post office lobbies. These publications are also sent to consumers inquiring for additional mail fraud information. The booklets outline various fraud schemes in an attempt to educate and protect the consumer.
- 3) A pilot program conducted in Birmingham, Alabama, showed successful results in combatting boiler room fraud. In Fall 1984, all small businesses in Birmingham were notified by direct mail regarding the perils of COD boiler room fraud. In the Spring of 1985, the local post office was contacted to determine the number of COD parcels that were refused as a result of our direct mail piece. We determined that

approximately 1,400 parcels averaging \$125.00 each were refused by the postal customer as a direct result of our warning notice. In this case, a potential \$175,000 was saved by postal customers.

As the result of the success of the Birmingham project, the Inspection Service is currently developing a direct mailing to be sent to small businesses nationwide. This mailing will warn small businesses about COD boiler room fraud.

- 4) A post office lobby poster is being designed to educate postal customers about COD fraud schemes.

In addition to the prevention efforts I have just described, we are also pursuing a vigorous enforcement program against boiler room fraud schemes.

The statutory authority available to the Postal Service to combat this activity includes two of the nation's oldest consumer protection laws:

The Postal False Representation Statute and
The Criminal Mail Fraud Statute.

We rely heavily upon the False Representation Statute and a supporting injunction statute. Under this authority, we obtain consent agreements, mail stop and cease and desist orders. This promptly protect

the public from being victimized by returning the money to the sender, thus depriving the promoter of the proceeds from the scheme.

The Mail Fraud Statute provides for a fine of \$1,000 and imprisonment of up to five years for intentionally devising a scheme to defraud via the U.S. Mails. In March, H. R. 1581 was introduced by Congressman Claude Pepper which would increase the maximum penalties to \$10,000 and 15 years imprisonment.

The bill also includes civil and criminal forfeiture provisions which would allow the Postal Service to seize the fraudulent promoter's assets and permit us to provide restitution to the victims. Currently, our only recourse to get relief for victims is to hope restitution is ordered by a federal judge during the sentencing process of a con artist.

Since 1983, the Inspection Service has been an active participant in a continuing nationwide enforcement crackdown on fraudulent boiler room operations. To date, two nationally coordinated interagency task forces have been assembled. The first effort in 1984, utilizing personnel from the Inspection Service, FBI, and Departments of Justice and Interior, focused on the boiler room sales of oil and gas leases. The second targeted ad speciality boiler room sales activity. Since this project was initiated in 1983, criminal actions have been taken against literally hundreds of boiler room operations nationwide, resulting in substantial prison terms and criminal penalties for violators.

A Postal Inspector from our National Headquarters was recently part of a Justice Department team that visited U.S. Attorneys in Miami and Los Angeles urging them to place a high priority on boiler room fraud prosecutions. The results of this effort are encouraging as U.S. Attorneys are now aggressively pursuing these cases. As a result, a local task force composed of agents from the FBI, Postal Inspection Service, Commodities Future Trading Commission, Securities and Exchange Commission, Department of Justice and local authorities convened in Los Angeles to concentrate efforts on the most significant boiler room operations primarily involved in investment and merchandise related scams.

Let me briefly describe a few cases to illustrate the magnitude and the diversity of these schemes.

On April 9, 1985, 18 individuals received sentences up to 20 years for their participation in Florida based boiler room oil and gas investment sales operations. The subjects had been found guilty on mail fraud and conspiracy charges in connection with the operation of U.S. Oil and Gas Corporation, Stratford, and Eagle Oil and Gas. The investigation spanned three years and culminated in a fourteen week trial. Approximately 10,000 victims were defrauded of nearly \$56 million.

The investigation spanned three years and culminated in a fourteen week trial. Approximately 10,000 victims were defrauded of nearly \$56 million. The principal in the scheme, Gurdon Wolfson, received 20

years in jail; one subject received four years; five received three years; three received two years and the remaining defendants received between three months and one year. Only two received probation. At the time of sentencing, the judge said a particularly harsh sentence was needed to let the public in South Florida know the courts will no longer tolerate this kind of activity.

On June 29, 1984, a temporary restraining order was issued by a United States District Court judge against Continental Pen, Inc., and U.S. Premium Products, Inc., of St. Paul, Minnesota, and the principals in both firms, John E. and Barbara L. Farkas. Continental Pen sold advertisement specialty items through telephone solicitations throughout the country. Purchasers were first contacted over the telephone or by certified mail and advised they were one of 101 winners selected to receive a fishing boat. The individuals then received a letter from U.S. Premium Products advising them that in order to receive the boat, they had to pay a \$62.00 redemption fee. We received numerous complaints that the victims did not receive the boat. On September 4, 1984, the U.S. Postal Service filed a cease and desist order against the company and its principals. Shortly thereafter, the operators altered their modus operandi and continued the same scheme avoiding direct use of the United States Mails and utilizing a credit card telephone solicitation. A federal search warrant was issued and executed which effectively closed down the promotion of Continental Pen and U.S. Premium Products. At the time of the search, \$15,000 in cash and \$60,000 in uncashed checks were recovered. The cash and checks were returned to the victims. It is

estimated that approximately 10,000 individuals were victimized in this scheme resulting in a \$2 million loss. At one point in time, Continental Pen and U.S. Premium Products employed 40 individuals. Investigation is continuing.

The next case example demonstrates how boiler room promoters travel from one part of the country to another to avoid prosecution.

On January 25, 1985, Postal Inspectors arrested Kevin Krol for operating a fraudulent COD scheme in the Scranton, PA, area. Krol was doing business as Horton Manufacturing and McNeil Manufacturing and used addresses of telephone answering services in Scranton, Stroudsburg, Hazleton, PA; and Charlotte and Wilmington, NC. Small businesses were targeted and telephone calls made to advise the victims they had won a computer. To keep from being responsible for the "Sales or Luxury" tax on the computer, the victims were urged to purchase advertising articles from Krol at a cost of from \$49 to \$95 per shipment. The victims were advised that Krol's company was required by the "Federal Sweepstakes Commission" to file an "R-30 Report" on winners. Winners were advised they would avoid a tax if they purchased the advertised articles from him. The articles were sent COD via United Parcel Service. The proceeds of the CODs were sent via the U.S. Mail to the mail receiving address. Krol was a fugitive who had been indicted for mail fraud in April 1983 in Las Vegas, NV. He is wanted by the State of New Jersey and, reportedly, by the State of California. Krol admitted he fled Las Vegas to San Diego, then traveled through Texas to Florida, and it

is believed he was operating this same scheme in other cities. Krol is being held without bail as a federal prisoner.

On September 5, 1985, a Federal Grand Jury at Los Angeles returned a 50 count indictment charging nine people with mail fraud for their roles in a nationwide office supply "boiler room" scheme.

The indictment alleges that the managers trained sales personnel to phone businesses at random throughout the United States and use a deceptive sales pitch to give the false impression that Park Distributing was affiliated with the business' regular supplier of photocopier products. The victim businesses were told they had been overlooked when notification of a recent price increase went out and, therefore, as a "courtesy," supplies had been processed at the "old price" to cover the business "one last time." These fraudulent pretenses and misrepresentations induced numerous businesses to place an order. Only later did they discover, often after payment had been made, that Park Distributing was not affiliated with their regular supplier; price increases had not occurred; the supplies eventually shipped were not the brand or quality expected; the price was not a discount; and invoices were further inflated with unexpected and unidentified charges. Losses are estimated in the millions of dollars. Trial is pending and more indictments are expected.

The sales personnel allegedly used a deceptive sales pitch to give their victims the false impression that Park Distributing was affiliated with their regular supplier of photocopier products.

Losses are estimated in the millions of dollars. Trial is pending and more indictments are expected.

At its peak, Park Distributing Company was the largest office supply boiler room operation in the nation. It operated under 16 corporate names and 15 trade styles. The corporation was grossing over \$18 million a year in telephone solicitations of office supplies and "premium prizes." They employed over 250 people, of which approximately 175 were telephone sales solicitors. Their annual payroll was estimated at over \$2.5 million. It is estimated that their telephone sales force solicited approximately 15,000 small businesses daily, generating \$60,000 a day in sales. We have received over 2,000 complaints on the firm since late 1980.

In closing, let me emphasize that the key ingredients in any effort to curb fraudulent boiler room activity is to increase public awareness of the problem and maintain our vigorous enforcement effort. I strongly believe that the hearings your committee is holding today will help increase the public's awareness of this nationwide problem.

I will be happy to answer any questions you may have.

Mr. SIKORSKI. Let's go on to Mr. Dillman's statement. He is going to tell us of the good work that has been going on just recently.

TESTIMONY OF DONALD D. DILLMAN

Mr. DILLMAN. Thank you, Mr. Chairman.

Mr. Chairman, I am Donald D. Dillman, Director of the Office of Mail Classification. I have come to talk about ways in which we plan to improve COD service to provide greater protection to the American consumer.

First, however, COD is a service that allows a shipper to mail an article on request without prepayment and have the charges collected from the addressee at the time of delivery. Currently, this service guarantees one of two alternatives to the mailer. Either the mailer receives a Postal Service money order in payment for the article mailed, or the article will be returned. Conversely, at the time of delivery the addressee must either pay for the article or refuse it, in which case it is returned to the sender.

Mr. SIKORSKI. He has to pay for the package or refuse it.

Mr. DILLMAN. That is correct. He has to pay the total amount or refuse it.

Mr. SIKORSKI. Collect on delivery.

Mr. DILLMAN. Yes, sir.

Mr. SIKORSKI. I think the marketing people are going to say it's really collect before delivery, before they get the article in their little hands.

Mr. DILLMAN. As in all of its services, at no time does the Postal Service attempt to determine the contents of the parcel, the reason why it was sent, or the agreements that may exist between the sender and the recipient.

I would like to describe today two proposals which we believe—

Mr. SIKORSKI. I think it's important—I thank you for trying to summarize, but it's important that gross revenue from COD service is approximately \$23 million per year, which isn't much in the total revenues. You handle 131 billion pieces of mail. Your gross revenues are \$25 billion. So, we're talking about something that is less than 1 percent.

Mr. DILLMAN. That's correct.

Mr. SIKORSKI. It's 1 percent, \$23 million per year, and a volume of approximately 12 million parcels. Five percent of this volume, about 600,000 articles a year involve fraud?

Mr. DILLMAN. Yes, sir.

Mr. SIKORSKI. Thank you.

Mr. DILLMAN. The first is a recommendation originally proposed by the National Association of Attorneys General, which would allow payment for COD parcels to be made directly to the shipper. The Postal Service at first rejected this proposal because of our concern that it could either unreasonably dilute the COD service currently available to all mailers, the vast majority of whom are not engaged in fraudulent schemes, or leave the Postal Service in the position of making good on bad checks or checks on which a stop payment order has been issued. Because of the magnitude of the fraud problem, however, we have come to believe that, despite

these drawbacks, the time has come to alter COD service in the interest of helping the consumer resist this type of fraud.

Under the current system, the basic problem in dealing with fraud is that the service includes a guarantee of either return or payment for the COD parcels. We propose that, instead of guaranteeing payment, the Postal Service allow the addressee to decide how to pay for the COD article when delivered. At that time the addressee would be permitted to write a check made out to the mailer which the Postal Service would then forward. If there was some problem with the merchandise, the addressee would have the opportunity to stop payment on the check before it is cashed.

Under this proposal, the Postal Service's COD service would more closely resemble the COD services offered by other shippers in connection with their parcel delivery operations, with one exception: Other shippers generally allow the mailer to specify whether a check or money order will be accepted. Our proposal would allow the recipient to make that choice.

We believe this system would hit directly at the fraud problem by giving the addressee an effective recourse for avoiding payment for fraudulent merchandise. At the same time, legitimate mailers could continue to operate their businesses without substantially increased costs. Of course, under this revision of COD service, the Postal Service would no longer guarantee payment to the mailer.

Since this can be considered a change in the nature of COD service, the Postal Service will recommend to the Board of Governors of the Postal Service that it submit a filing to the Postal Rate Commission for consideration under the procedures set forth in the Postal Reorganization Act. We will ask the Commission, once it provides an opportunity for a hearing to all interested parties, to issue an advisory opinion on the matter to the Postal Service. We expect the Postal Rate Commission will recognize the need to deal with this situation promptly and will consider our proposal on an expedited basis.

In addition to this proposal, the Postal Service plans to extend its efforts to make consumers more aware of how COD works. In that regard, we will of course have more local media announcements, but we will also have posters displayed in local post offices and have warnings printed on a newly designed COD label. These efforts should draw customers' attention to COD service.

These steps reflect our concern over the harm done by the abuse of our COD service. At the same time, we remain concerned with the needs of the vast majority of COD mailers who operate legitimate businesses, as well as of the consumers to whom we deliver their parcels. It is our opinion that the actions we have just outlined will go a long way toward meeting the needs of the consumer and legitimate mail order shippers.

For similar reasons, the Postal Service is opposed to another proposal of the National Association of Attorneys General to allow the addressee to inspect an article at the time of delivery before deciding to accept it. Though this proposal has surface appeal, its effect on COD costs would be so large as to suggest that the best alternative for the Postal Service and mailers would probably be to discontinue COD service rather than implement this change.

There are two important problems with allowing the inspection. First, it would increase, perhaps drastically, the costs associated with COD service. Second, it is likely to embroil the Postal Service in disputes and possibly litigation over lost and damaged merchandise. While both these problems are serious, it is the first which poses the greatest threat to the continued provision of COD service.

Mr. SIKORSKI. If I might interrupt.

Mr. DILLMAN. Yes.

Mr. SIKORSKI. It really has to be the first, because you are embroiled in the fight now, because you get someone who opens the box and finds these worthless pieces of glass instead of semiprecious stones. I know, from experiences I have been told of, that you are kind of caught, you're in the middle. You have been collecting for the boilerroom operations.

Mr. DILLMAN. Yes, sir.

Mr. SIKORSKI. Right. So, really, it's a matter of having an open box right there and then getting caught with wrapping and unwrapping, and waiting while people inspect and make a decision.

Mr. DILLMAN. That is correct.

Of course, as you are aware, the cost of our carriers to deliver an article is one of our major costs of doing business. As a matter of fact, we feel that, at a minimum, our costs for COD service would probably increase about \$2.05 across the board.

Mr. SIKORSKI. If you had to wait?

Mr. DILLMAN. Yes, sir, if we had to wait.

Mr. SIKORSKI. For inspection?

Mr. DILLMAN. Yes, sir.

And that's based upon only a 5-minute wait on the average. If you have a parcel which had a number of items in it, such as knives, pencils, and the like—

Mr. SIKORSKI. Or a boat—

Mr. DILLMAN. Or a boat.

Mr. SIKORSKI. The oars—

Mr. DILLMAN. It may take a lot more time.

Mr. SIKORSKI. With electronically sealed seams and—

Mr. DILLMAN. And really look those over well.

Mr. SIKORSKI. Go down to Lake Minnetonka and put it into the lake there.

Mr. DILLMAN. I've been there. I would rather not be in that boat on that lake.

Mr. SIKORSKI. No.

Mr. DILLMAN. Our cost of delivery is a significant one. And 5 minutes, probably, is a very, very conservative number. That 5 minutes' cost is \$1.88. In addition to that, we would have a rewrap and reshipping cost involved. Our rewrap and handling, on the average now, cost us \$3.35—that is to fix a package and return it back to the sender. If only 5 percent, taking the fraudulent figure, were returned, that cost would be 17 cents for each COD parcel. So, the \$1.88 and the 17 cents amount to a total cost of \$2.05.

You can easily see that there would be returns from legitimate mailings as well as fraudulent mailings. Therefore, that 5 percent is probably very, very conservative. So, we are very concerned about that cost effect.

In closing, we believe that the plans we have outlined today go a long way toward curbing the present abuses of COD. By changing the nature of COD in this way, I believe that we can help reduce these abuses to the service and stop the defrauding of the public.

I will be happy to answer any questions.

[Statement of Donald D. Dillman follows:]

STATEMENT OF DONALD D. DILLMAN, DIRECTOR, OFFICE
OF MAIL CLASSIFICATION, RATES AND CLASSIFICATION
DEPARTMENT, UNITED STATES POSTAL SERVICE, BEFORE
THE INVESTIGATIONS SUBCOMMITTEE OF THE HOUSE
POST OFFICE AND CIVIL SERVICE COMMITTEE.

November 14, 1985

Mr. Chairman, I am Donald D. Dillman, Director of the Office of Mail Classification at the U.S. Postal Service. I am here today at your request to discuss the problem of consumer fraud arising from abuses of Collect on Delivery or COD Service.

I would like to start by saying on behalf of the Postal Service that we share with you the concern that some mailers take advantage of COD service to obtain money in a fraudulent manner from people who receive a product different from or vastly inferior to the one they ordered. As you know, the Postal Service has always been deeply involved in the effort to help protect the American public from fraudulent mail order schemes where the use of the mails is an essential part of the operation. For example, during fiscal year 1984 Postal Inspectors conducted 2,473 fraud investigations and secured restitution for victims totaling more than \$4, million. The Postal Service has a continuing commitment to preventing the use of the mails for consumer fraud, and I have come to you today to talk about the ways in which we plan to improve our COD service in order to provide greater protection to the American consumer.

COD, which is primarily used in connection with parcel post, is a service that allows a shipper to mail an article on request without prepayment, and have the price, the cost of postage and fees, insurance, and anticipated or past due charges collected from the addressee at the time of delivery. Currently, our service guarantees one of two alternatives to the mailer: either the mailer receives a Postal Service money order in payment for the article mailed, or the article will be returned. Conversely, at the time of delivery the addressee must either pay for the article or refuse it, in which case it is returned to sender. As in all of its services, at no time does the Postal Service attempt to determine the contents of the parcel, the reason why it was sent, or the agreements that may exist between the sender and the recipient.

Today, the gross revenue from COD service is approximately \$23 million per year, on a volume of approximately 12 million per year. Our Inspection Service estimates that about 5 percent of this volume, or about 600 thousand articles a year, involve fraud. We have considered several options for alleviating the problems caused by fraudulent use of the service, while keeping in mind the interests of both the legitimate mailer, who uses and pays for the service, and the parcel recipient. I would like to describe to you today two proposals which we believe would significantly improve the

situation, while maintaining the Postal Service's primary role as a carrier and deliverer of mail. The first is a recommendation originally proposed by the National Association of Attorneys General which would allow payment for COD parcels to be made directly to the shipper.

The Postal Service at first rejected this proposal because of our concern that it could either unreasonably dilute the COD service currently available to all mailers, the vast majority of whom are not engaged in fraudulent schemes, or leave the Postal Service in the position of making good on bad checks or checks on which a stop order has been issued. Because of the magnitude of the fraud problem, however, we have come to believe that, despite these drawbacks, the time has come to alter COD service in the interests of helping consumers resist this type of fraud.

Under the current system, the basic problem in dealing with COD fraud is that the service includes a guarantee of either return or payment for COD parcels. We propose that instead of guaranteeing payment, the Postal Service allow the addressee to decide how to pay for a COD article when delivered. At that time the addressee would be permitted to write a personal check made out to the mailer in exchange for the parcel, which the Postal Service would then forward to the mailer. If there was some problem with the merchandise, the addressee would have the opportunity to stop payment on the

check before it is received and cashed. This would also give the parties involved in the transaction the opportunity to resolve their differences without recourse to the Postal Service. As a side benefit, the addressee would not have to pay a money order fee, thus saving money on the transaction.

We would also allow the addressee to pay for the article in cash, pay the money order fee, and have the Postal Service send the money order to the mailer to pay for the article, just as we do today. This would prevent the withdrawal of COD service from those individuals without access to a checking account.

Under this proposal, the Postal Service's COD service would more closely resemble the COD services offered by other shippers in connection with their parcel delivery operations, with one exception: other shippers generally allow the mailer to specify whether a check or money order will be accepted. Our proposal would allow the recipient to make that choice.

We believe this system would hit directly at the fraud problem by giving the addressee an effective recourse for avoiding payment for fraudulent merchandise. At the same time, legitimate mailers could continue to operate their businesses without substantially increased costs. Of course, under this revision of COD service the Postal Service would no longer guarantee payment to the mailer.

Since this can be considered a change in the nature of COD service, the Postal Service proposes to submit a filing to the Postal Rate Commission for consideration under the procedures set forth in the Postal Reorganization Act. We will ask the Commission, once it provides an opportunity for a hearing on the record to all interested parties, to issue an advisory opinion on the matter to the Postal Service. We expect that the Rate Commission will recognize the need to deal with this situation promptly, and will consider our proposal on an expedited basis.

In addition to this proposed change, the Postal Services plans to extend its efforts to make consumers more aware of how COD service works and the danger of accepting COD parcels disguised as gifts or prizes. These efforts can include public service announcements in local media, posters displayed in local post offices, and warnings printed on a redesigned COD label.

These steps reflect our concern about the harm done by abuse of our COD service. At the same time, we remain concerned with the needs of the vast majority of our COD mailers that operate legitimate businesses, as well as the consumers to whom we deliver their parcels. It is our opinion that the actions that we have just outlined will go a long way towards meeting the needs of both consumers and legitimate mail-order shippers.

For similar reasons, the Postal Service is opposed to another proposal of the National Association of Attorneys General to allow the addressee to inspect an article at the time of delivery before deciding whether to accept it. Though the proposal has a surface appeal, its effect on COD costs would be so large as to suggest that the best alternative for the Postal Service and mailers would probably be to discontinue COD service rather than implement this change.

There are two important problems with allowing inspection. The first is that it would increase, sometimes drastically, the costs associated with COD service. Secondly, it is likely to embroil the Postal Service in disputes, and possibly litigation, over lost and damaged merchandise.

While both of these problems are serious, it is the first which poses the greatest threat to the continued provision of COD service. At a minimum, we estimate that each carrier would be delayed an average of five minutes while waiting for customers to inspect COD articles. This delay would be required for the addressee to open the package, remove the contents and examine them. However, the five minute delay occurs in the least costly circumstance when the contents are accepted. In those instances where the contents are not accepted, substantial additional costs would be incurred. First, the contents would have to be rewrapped. Since the recipient has just rejected the parcel, it's unlikely that he or she will think of it as theirs or take any interest in

rewrapping it, so the Postal Service will have to take responsibility for repackaging the parcel. Secondly, as in its original trip to the addressee the article must be sorted, transported and delivered.

As you know, the Postal Reorganization Act requires that fees for a service must cover the costs that can be directly and indirectly attributed to providing that service. Based on the assumption that only the 5 percent of all parcels which we estimate involve fraud are returned, and under the best of circumstances, the Postal Service estimates that the total cost of addressee inspection would be at least \$2.05 for each COD piece mailed. Thus, a fee increase in excess of 100 percent would be required to recover the increased cost. Of course, this is a fee increase which would apply to all COD mailers, including the legitimate businesses which send the 95 percent of COD parcels which are not part of the problem.

As I mentioned, the inspection proposal is also likely to lead to many disputes pertaining to damaged or missing items. The time between the opening of the parcel and its resealing allows numerous opportunities for theft, loss, and damage. At the very least, it is likely to lower the value of COD service substantially for the legitimate business user.

In addition to the proposals I have discussed today, the Postal Service has considered the possibility of establishing some system whereby it could guarantee to the addressee return of his or her money in the event of fraud. We see two

fundamental obstacles to such a guarantee. First of all, it is difficult to separate problems involving fraudulent merchandise from consumer complaints that do not involve fraud. Secondly, a guarantee would inject the Postal Service directly into the resolution of disputes between companies and their customers. We believe this leads us far astray from our basic job, which is delivering the mail.

In closing, let me once again state that the Postal Service is committed to the prevention of consumer fraud through the mails wherever possible. We believe that the plans we have outlined today go a long way towards curbing the present abuses of the COD. By changing the nature of Collect on Delivery service in the way I have described, we hope to make it much more difficult for the abuser of the service to get away with defrauding the public.

I will be happy to answer any questions which you may have.

Mr. SIKORSKI. I want to again salute you for coming up with the suggestion. That is not going to be noncontroversial. I think the weight of the evidence is clearly on your side. You said the process is going to be expedited. How soon can we expect that the Rate Commission will be setting its hearing and then making a decision?

Mr. DILLMAN. Mr. Chairman, it will take us something on the order of 30 days to get this to our Board of Governors. As you know, they meet once a month.

Mr. SIKORSKI. Yes.

Mr. DILLMAN. They have just met. Once the Postal Rate Commission has this—assuming the Board does agree—we could implement this on a temporary basis within 90 days.

Mr. SIKORSKI. I want to compliment you for that turnaround time. Then it would be a final process it will go through before it can be implemented finally.

Mr. DILLMAN. Yes.

Mr. SIKORSKI. I want to compliment you for moving on that and creating that kind of timeframe. Very seldom do you get that response around here. I want the subcommittee to be informed as the process goes along. Should it be necessary, I would like the subcommittee to put submissions into the record for the Board of Governors or the Rate Commission or both in that hearing process so that what we have been able to accumulate gets into the record.

Mr. DILLMAN. Thank you.

Mr. SIKORSKI. Thank you.

I know, Mr. Swagerty, it's difficult. You really can't tell how many fraudulent complaints, or complaints of mail fraud involving

c.o.d. have been brought in or what the numbers are. But what you have been able to do is quite helpful in emphasizing the dimensions of the problem.

Do you have any further comments you would like to make?

Mr. SWAGERTY. Yes, if I could, just two very quick things I would like to comment on.

Mr. SIKORSKI. You looked as though you wanted to say something.

Mr. SWAGERTY. Thank you, I would like to comment on this. We are aware of this company out in California, the United Federal Distributors. We are investigating them at this time. We believe that it is part of a bigger operation than just that one name, including such other names as Pacific Freight, National Businessmen's Cooperative, Colonial Distributors, and Oceans Promotions—

Mr. SIKORSKI. Oceans Promotions?

Mr. SWAGERTY. Yes.

The Coast Guard has been in contact with us because, obviously, this is also a very dangerous thing.

The only other thing that I would like to say is I would like to compliment very much D. Ann Murphy, a very intelligent, hard-charging lady, who did an excellent job.

Mr. SIKORSKI. She is. That's why she's here.

Again, gentlemen, thank you.

Now it's a pleasure to introduce two individuals representing the direct mail and telephone marketing industries, the legitimate groups that are, too, victimized by the kinds of schemes and scams we've heard. Don Dunham is senior vice president DialAmerica Marketing. Michael Fisher is vice president/secretary and general counsel for Fingerhut Corp.

Do either of you have objections to being sworn in?

Mr. DUNHAM. No.

Mr. FISHER. No.

Mr. SIKORSKI. Do you solemnly swear that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. DUNHAM. I do.

Mr. FISHER. I do.

Mr. SIKORSKI. The subcommittee would be remiss if we did not recognize that there are hundreds of legitimate direct mail and telemarketing companies throughout the country, which in a real sense, as we have said, are also victimized by these con artists. We have to balance the need for these legitimate businesses to do the business that they do and provide the services that they provide the American people, with the need also to prevent millions of American consumers from being swindled out of billions of dollars by the illegitimate, illegal operations.

We are fortunate to have with us today two representatives from industry. Mike Fisher represents Fingerhut Corp., which I understand is the largest direct mail company in the United States. It also happens to be headquartered in my State of Minnesota. It is always a pleasure to welcome a fellow Minnesotan.

Mr. Don Dunham, representing DialAmerica, will also be explaining their operation and how they have been affected by these

illegal boilerroom operations and talk about some of the things we can do and not do, from your perspective.

Mike.

TESTIMONY OF MICHAEL B. FISHER, VICE PRESIDENT/SECRETARY, GENERAL COUNSEL, FINGERHUT CORP.; AND DONALD R. DUNHAM, SENIOR VICE PRESIDENT, DIALAMERICA MARKETING, INC.

Mr. FISHER. Mr. Chairman, thank you. Thank you very much for the opportunity to testify.

I work for Fingerhut Corp., a large direct mail marketing company headquartered in Minnesota. I have been requested to share with you today not only my company's concerns but the concerns of other members of the Direct Marketing Association about the abusive practices. We couldn't agree more. And I will certainly endeavor to cut out what we have heard. We share views—

Mr. SIKORSKI. Good. I see that you cut out the salutation, which was good morning with an exclamation mark.

Mr. FISHER. We tried hard for that.

Mr. SIKORSKI. It's just afternoon back in Minnesota, and it's still morning in California.

Mr. FISHER. Thanks.

The Direct Marketing Association has more than 2,700 members serving all phases of the industry. We do share your concerns. We think legitimate businesses are tarnished by businesses which do not have such proper concerns and, therefore, look for solutions to these problems. Reputable firms do make refunds or adjustments.

We heard earlier Mr. Murray testify about c.o.d. abuses, which are occurring in Minnesota; and Mr. Swagerty indicated they are occurring elsewhere. Thousands of firms in the direct marketing industry have developed ethical guidelines. We certainly wish to assure the subcommittee that the kinds of activities described here this morning fall far below the standards in those guidelines.

Since c.o.d. abuses have not been widely brought to our attention in the past, there is not a specific set of guidelines dealing with them; but certainly the behavior described here would violate many other ethical standards of behavior accepted by Direct Marketing Association members.

But we do want to correct those problems. We simply ask that all recognize c.o.d. is a valuable tool to members of our industry as well as other segments of the economy who must secure merchandise by mail or in some cases other private delivery companies. It's important to note that other private delivery companies offer this feature. One of the things that we are looking for because of our sincere interest in this problem is that there be a similar set of rules so that the bad guys, if you will, will not flock to options other than the Postal Service to perpetrate the same type of undesirable business.

Mr. SIKORSKI. Maybe you can help on that. Do UPS and the others provide a money order kind of situation? I think the Postal Service has testified that they are going to recommend this change with—option of payment, say, use a check which allows a stop payment, a kind of a cooling-off period.

Mr. FISHER. To my knowledge, the facts are as Mr. Dillman stated. At least some of the other private delivery services allow the shipper to give instructions to the shipping company, accept checks, accept cash only; and then the goods are sent out on that proviso. We certainly don't want to leave any place to hide for the people who aren't doing it right.

Mr. SIKORSKI. That's the important point.

Mr. FISHER. The most important thing that I would like to amplify that we haven't heard—this is all important, but some of the new facts we can bring to light—is that c.o.d., while it allows customers to order goods without having to send money ahead of time, does require payment ahead of real delivery. In a sense, it's cash before delivery. Thousands of times every day, the system works satisfactorily; but people should understand what it means so it can work even better.

How can we remove abuses without breaking down the system? One suggestion is to allow customers the right to inspect packages before payment. In this regard, we share Mr. Dillman's concerns. He explained them very articulately. We think the Postal Reorganization Act would require pricing such a service out of workability.

But I am pleased that other constructive approaches have been suggested, approaches such as checks payable to the vendor rather than to the Postal Service. This would presumably allow customers to stop payment in the event that things did not meet expectations. I would think the Postal Service might also be willing to explore other suggestions such as revised enforcement procedures, bonding mechanisms, or other improved disclosures. We are receptive to all such changes which will address this. What we are concerned about and look forward to an airing of these issues is that the unintended result of reform working c.o.d. out of existence. We very much are concerned that these be looked at, but they certainly sounded constructive to us and, upon fully understanding them, think they make a giant step in addressing these problems.

In many cases of c.o.d. abuses, customers have entered into transactions which appear too good to be true. We have heard a lot about that this morning. The post office, in effect, ends up lending an endorsement to the product because it comes in the mail; this is unfortunate.

It's true that fraudulent merchants are playing upon the misconception to induce more consumers to part with greater sums of money. The solution to this problem is effective public education. The post office is in a better shape to reach postal patrons than any other medium. There is no question that the type of thing Mr. Murray is doing is constructive and brings the good message to more people. There's no question that an interested and dedicated force of postal inspectors can educate a far greater number of people. Yet, it is the Postal Service itself who can reach each and every postal patron and tell them quite simply that c.o.d. doesn't mean you get a right of inspection; it means you have to pay before you get the goods. In a realistic sense, it is very similar to paying in advance. Hopefully, through meaningful undertakings by the Postal Service, the public would come to understand better than it

does today, certainly, that c.o.d. is virtually identical to paying in advance.

Better education and public awareness of what c.o.d. means can certainly make a large dent in the c.o.d. abuse problem. If additional measures are necessary, we support measures designed to address the problems, as indicated. We consider c.o.d. to be a very valuable tool and respectfully request that any consideration of alterations in the system take into account all interstate uses of c.o.d. by all carriers.

Thank you again for affording us this opportunity.

Mr. SIKORSKI. Thank you.

You have about 2,700 members, as I understand?

Mr. FISHER. Yes.

Mr. SIKORSKI. We are talking about, did you say, tens of thousands?

Mr. FISHER. Thousands of transactions every day, if there are 12 million c.o.d. transactions, it would mean thousands.

Mr. SIKORSKI. And it would not be an exaggeration to say there are thousands of direct marketing companies.

Mr. FISHER. Many of whom use c.o.d. And for them it works. It's a valuable tool. Our own firm, for example, while we make very limited use of c.o.d., unquestionably offers a return privilege to our customers that operates separately from however they might choose to pay us.

Mr. SIKORSKI. Are you the largest?

Mr. FISHER. We are the largest direct marketing company, we believe. That is to say, we send out advertisements which try to encourage purchases. This is to be distinguished from perhaps the type of large mail order catalog we are all familiar with. This is a different type of mail order selling.

Mr. SIKORSKI. Small brochures, inserts, and things like that?

Mr. FISHER. Right. These large catalog companies, household names we have heard, Sears or Penney's—

Mr. SIKORSKI. But you take checks, and you have an independent billing process.

Mr. FISHER. We take checks. We will offer house credit. We will accept payment in any number of ways. We have looked at c.o.d., and it works for us; but because we are comfortable with our customers, in our particular case it's not a large tool for us. It is across the board in the DMA a very important tool for payment, however.

Mr. SIKORSKI. Good. I thank you very much.

Mr. FISHER. Thank you.

Mr. SIKORSKI. Mr. Dunham, tell us about the telephone aspect of direct marketing. You've been around it for 24 years.

TESTIMONY OF DONALD R. DUNHAM

Mr. DUNHAM. That's right. Thank you, Mr. Chairman.

I am here to testify really that not all telemarketers operate boilerrooms. Most, like most businesses, are highly ethical.

Mr. SIKORSKI. I know you mention in your statement that you have seen a lot of small unsophisticated local telephonerooms, boilerrooms. My understanding is that term now has taken on pejora-

tive connotations, and it virtually is used by law enforcement people only in the instance of telephonerooms or banks that are used for fraudulent purposes. I have used boilerroom in the past, the term in the past to mean a telephone bank, which politicians do a lot of—and no comment, Neil Murray. [Laughter.]

It's my understanding now the boilerroom term is now only used by law enforcement people in a fraudulent case, where people are using the telephone banks for fraudulent purposes.

Mr. DUNHAM. It is certainly used in our industry as well, but, as you say, it's a negative connotation. If somebody says that you operate a boilerroom, you know, it's that type of thing. It is not the type of thing that we want to be associated with.

I have been with DialAmerica Marketing for 24 years. I have seen it grow from a very small operation. We had a lot of very small offices that certainly resemble what I would call a boilerroom. They don't look the same anymore. Companies like DialAmerica and Wats Marketing of America, and many of the other major companies are highly sophisticated, computerized organizations. DialAmerica is 28 years old. We are one of the oldest in the industry. We have 60 branch offices from coast to coast, 1,700 outbound telephones, 3,000 representatives making over 700,000 outbound phone calls per week.

Mr. SIKORSKI. You make over two-thirds of a million phone calls a week.

Mr. DUNHAM. Yes. We figure about 35 million calls a year.

Mr. SIKORSKI. Let your fingers do the walking. And you're just one.

Mr. DUNHAM. We're just one.

Mr. SIKORSKI. Are you the largest?

Mr. DUNHAM. We think we are the largest. We have approximately 40 different clients that we're working for at any one particular time, most of which are Fortune 500 companies. We are working with firms such as Time, Inc.; Xerox; Citibank; Chase Manhattan; AT&T; New York Telephone; Southern Bell; firms of that magnitude that come to DialAmerica. We spread their message via the telephone.

I don't have to tell anyone here that the telephone marketing industry obviously is growing and growing and growing and growing. AT&T indicated to us that last year \$13.6 billion were spent on phone costs and equipment: phones, lines, and computers. Companies using the technique today are IBM, Merrill Lynch, Chase Manhattan Bank, Allstate, and, yes, AT&T, too. Telemarketing is a very, very hot industry right now.

In the past, telemarketing has been provided mainly by modest sized service bureaus. Some companies specialize in inbound service, that is, taking orders and queries via "800" numbers; while others deal in outbound services to sell products and services. But today huge corporations are also entering the industry. Allstate and Montgomery Ward have begun in-house telemarketing to sell their products. American Express, Publishers Clearing House, and Dun and Bradstreet have all set up or acquired telemarketing units to serve other companies. American Airlines found it had more telephone equipment than it could use and created a telemarketing subsidiary that handles outbound calls for other companies.

DialAmerica is bigger today, better, and more sophisticated than in the past, simply because it has to be to compete.

The giant corporations entering the business today are well funded. They are technically advanced, and they are ethical, ingredients I believe necessary for long-term survival.

This year the DMA and the Telephone Marketing Council introduced telephone preference service. The TPS is patterned after the highly successful mail preference service which for over a decade has allowed consumers to have their names removed from mailing lists. Consumers who write to DMA will have their names and telephone numbers circulated to subscribing telemarketers for removal from their calling lists. It's a very good idea whose time has come. But DialAmerica has been doing the same thing for a number of years. We believe a bruised consumer is a friend to no one.

Whenever during the course of calling, someone says: do not call us again, or get me off your list, a do-not-call form is completed and entered into the data base, which is then matched against all future lists. No true professional wants to waste time and resources calling consumers who are not likely to be responsive. For the same reasons, all scripts are tested, tested, and then tested again to make certain that they are honest and complete, that the consumer will know the exact nature of what is being offered and the commitment involved.

There is a parallel between magazine and newspaper publishers and telephone marketing agencies that I would like to point out here. Many legitimate publishers have been criticized for accepting advertisements from companies with somewhat lower ethical standards. It is not easy for the advertising manager to turn an ad down when that ad is its life's blood. It's just as difficult to turn a telephone client down for the same reason. But an honest telephone marketer can find himself dealing with a firm whose products or services are less than they claim or their delivery, credit, guarantee, or refund policies are unsatisfactory.

At DialAmerica we turn down far more business than we accept, and we accept only clients that survive a Dun and Bradstreet investigation. And we feel good about the principals, their products, and their reputation.

Today the telephone is an essential part of everyday life for personal communications for business and industry. When properly managed, it is used as an organized and scientifically directed approach to marketing problems, and it is exceptionally effective and economically practical.

Consider the fact that the number of U.S. companies using some form of telemarketing, according to AT&T, is expected to mushroom from today's 80,000 to over 265,000 by 1990. In lieu of the testimony given here today, I doubt very much that Alexander Graham Bell, that Scotsman of such great vision and genius, ever visualized the many uses to which one of his greatest inventions would be put to use when he first spoke over that wire back in March 1876.

Mr. SIKORSKI. 80,000 companies to over 265,000 companies in just the next 5 years, an amazing, amazing statistic.

I thank both of you. I have a couple of questions. When you make initial contact with people, there must be—I'm in the same

business to a great extent—there's a general skepticism on people's part to any approach. You have to be affected by the kinds of problems that exist out here where these illegitimate and criminal operations come in and spoil, contaminate, the whole pool for you. You have to do some extra special things to overcome the resistance that has been reinforced by this kind of thing, don't you?

Mr. DUNHAM. Absolutely.

Mr. SIKORSKI. Do you have, DMA or the Telephone Marketing Council, do you have programs that build on public education format? Do you do PSAs or do any kind of public service information procedures?

Mr. DUNHAM. We have—

Mr. SIKORSKI. Why don't you supply what you do for the record? I think you do.

It is a narrow line you walk because you have to make sure that you are not spoiling, increasing resistance to your pitch for legitimate purposes at the same time you protect people from pitches of criminals that then close you off from the business.

Mr. DUNHAM. The biggest element in our business that we find most important, even more important than the telephone sales people that we hire, is in the management area. You have got to have very good on-line managers that are capable of excellent training. That's really the key to it. If you receive a phone call this evening from someone who is obviously reading a script, has no answers to any of the questions that you put to that individual, you're going to hang up; and you're justified to do so.

However, when you are called by a lady or a gentleman and they present themselves in that manner and they are well versed in what they are saying and they are not trying to jam something down your throat, you will generally listen; and that's really the key. Anytime that a legitimate marketer has something to say legitimately, people will listen to it.

Mr. SIKORSKI. Unfortunately, some of the slickest, the most smooth-sounding pitches come from these people who are lured by big bucks.

Mr. DUNHAM. There's no question about that, Mr. Chairman.

Mr. SIKORSKI. And they're saying anything. They'll tell old ladies or noted economists, international economists, anything to get them on line.

Mr. DUNHAM. It's not telemarketing—

Mr. SIKORSKI. I guess what I'm saying is I am not so sure that a receiver of a call can tell who's the good guy from who's the bad guy by listening to how melodious their pitch is and how professional they are.

Mr. DUNHAM. I think that's very true. And the same thing is true in any other form of business.

The telephone really is not an industry. It's a vehicle. We are just a few years away from the fact, I think, everybody in this country is going to be a telemarketer. The door to door salesman is a dinosaur today. Outside sales of almost all kinds, because of their costs, are becoming a thing of the past. We all in one sense or another are becoming telemarketers, whether we actually say that we're telemarketers or not. In any instance, you're going to have some people that are more honest than others, and that can be in

any industry or any business. The telephone is certainly not unique in that area.

Mr. SIKORSKI. In looking through some of the literature that the Postal Service and others have compiled, there are some handy-dandy guides to not getting rooked in this operation. I would like to see if you agree.

If you don't know who you are talking to, don't give them your money.

Never send money to a faceless voice over the telephone. If you have to, send a check.

Second, if you don't understand a contract, don't sign it. Beware of high pressure sales tactics that are aimed at forcing you to commit yourself before you understand the nature of the deal.

Third, don't be timid. Don't be overly courteous. If a call sounds suspicious or the pitch pressures you, hang up.

Fourth, if something sounds too good to be true, it probably is. There's no such thing as a can't-miss deal. If it can't miss, then it can't hurt to see the product first.

Five, business is business. Don't trust someone simply because of an affiliation. Know what you're getting yourself into. A friend in the same lodge and a friend in the same profession are sometimes the leads into these scams.

Sixth, if it doesn't make sense as a business, it doesn't make sense as a tax shelter. Better to pay taxes than lose everything.

And finally, remember the salesman gets his commission even if you don't get your investment or your investment return.

And use common sense.

Does that sound like pretty reasonable advice?

Mr. DUNHAM. It sure does.

Mr. FISHER. Yes.

Mr. SIKORSKI. Do you have anything you want to add, Mike?

Mr. FISHER. No.

Mr. SIKORSKI. I want to thank you people for helping broaden the information that is available to us and show the good side, which is about a 90 percent-plus part of this whole process.

I thank again the Postal Service for their involvement, Neil Murray and Fred Royle for coming here and sharing with us, the comptroller and the Floridians for assisting us. All of the witnesses today have been excellent. I am particularly pleased that the Postal Service is moving ahead on an announcement that they chose this hearing as a forum to make. It is clear that there still is a lot to be done, for example, working with others on the Post Office and Civil Service Committee and the Judiciary Committee, and particularly Congressman Pepper from the Select Committee on Aging perspective to develop the necessary legislative fixes to a nationwide, multi-billion-dollar problem.

The victims can be any one of us and probably include some of us here. We can't afford to stand idly by while these kinds of rip-offs occur, and I don't intend that this subcommittee will.

Again, thank you all.

The hearing is adjourned.

[Whereupon, at 1:40 p.m., the subcommittee was adjourned, subject to the call of the Chair.]