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Businesses Get Tougher on 'Friendly' Fraud

By PUI-WING TAM

Online merchants are fighting a surge in so-called friendly fraud, as more consumers try to get out of paying for their Internet purchases in the recession.

Online jeweler Ice.com Inc. and travel site [Expedia](#) Inc. are among companies seeing at least 50% spikes from October in friendly fraud, a term used to describe when a consumer disputes an online charge but doesn't return the item or has already used the product.

Common scenarios include consumers falsely claiming they never received a product or they received the wrong item. Other consumers deny they ever authorized the charge and refuse to pay for the item.

Since the markets tumbled last year, Ice.com says its rate of suspected friendly fraud has tripled, while Expedia says it's up 50%. Athletic shoemaker [K-Swiss](#) Inc. says it's seen suspected friendly fraud rise 10% since January.

'Friendly Fraud'

Photo-equipment supplier Calumet says a customer tried to get a refund for a \$600 camcorder, but sent back used power cords instead of the camera.



Calumet Photographic



Calumet Photographic

These companies say the fraud is sometimes blatant, with some consumers sending back boxes filled with rocks instead of the item that was shipped, and then asking for their money back. But in most cases it's hard to distinguish between fraudsters and consumers who legitimately don't receive their online purchases.

"Many people think [friendly fraud] is an easy way to reduce the amount they owe their credit card company," says Sanjay Sarathy, senior vice president of marketing for Vindicia Inc., a Redwood City, Calif., company that makes software to combat online fraud.

The problem is similar to what happens in retail stores when consumers return clothes or other items for a refund, after having already used the products, a practice known as "wardrobing" or "closeting." Overall, fraudulent returns to retailers totaled \$11.8 billion in the U.S. in 2008, up from \$10.9 billion in 2007, according to the National Retail Federation.

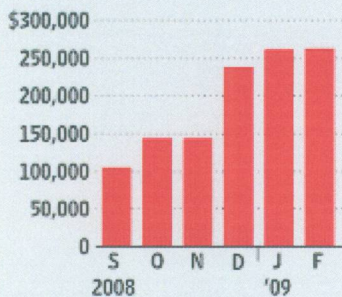
Companies are stepping up their vigilance against friendly fraudsters by analyzing computer records to identify consumers who charge back items more frequently. At Ice.com, the Champlain, N.Y., company also photographs every online order before packing the item into a box to be shipped, says Ezzie Schaff, vice president of risk management.

Mr. Schaff recently teamed up with police in Fayetteville, Ga., to catch a serial friendly fraudster. That individual bought a \$9,000 piece of jewelry from Ice.com, then claimed the wrong item was shipped and sent back a cheap watch in its place. After some police enquiries, the individual returned the jewelry and wasn't arrested, says Fayetteville police detective Marvin Vinson.

While there are no numbers on the costs that friendly fraud incurs, companies say they get penalized twice because they lose both the revenue from a sale and also the item. Tom Sullivan, Expedia's senior director of global payments and risk, says companies also carry extra labor costs associated with their investigation of disputed charges. In addition, he notes, companies that hit over a certain threshold of friendly fraud "chargebacks" are levied higher fees by banks and credit card companies.

Sneaking Goods

How friendly fraud spiked for a sampling of 20 companies in the last few months, in dollars for the total amount of chargebacks



Source: Vindicia

In Expedia's case, friendly fraudsters buy non-refundable plane tickets or trips through the site, but claim they never authorized the purchase, sticking the Seattle company with the cost of the tickets, or in some cases the entire trip, after it's been taken.

Photo-equipment supplier Calumet Photographic Inc. says it averages about \$130,000 a week in fraudulent orders through its Web site. About 30% of those are friendly fraud, while the rest are traditional frauds with stolen credit cards.

Scott Shulman, K-Swiss's director of e-commerce, says earlier this month, one person claimed he didn't receive his \$400 shipment of shoes. Mr. Shulman said he would send somebody to the customer's post office to pick up the card that showed someone had signed for the shipment. The consumer backed off his claim.

Write to Pui-Wing Tam at pui-wing.tam@wsj.com

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