

INTELLENET NEWS

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--Special Edition--
Product Counterfeiting and Diversion

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Ironies in Crime

Fred Bornhofen
Bornhofen & Associates
Elverson, Pennsylvania

Lest you think that all criminals are smart and successful in what they do and feel somewhat humbled when you hear of their exploits, imagine the following scenario involving deceit, forgery and counterfeiting of consumer products.

It all started in 1997 when reports were received that someone was selling large amounts of counterfeit world-class fragrances in Florida. Not to worry, my client was not involved, but I stopped by a confidential informant, who was explaining about the counterfeit products of the competitors being offered for sale. While he was talking in depth about these multiple brands that were being counterfeited, it was noticed that the informant had two bottles of my client's, men's cologne on display. Casually, we looked at the two units but the confidential informant was assuring us that this was quality merchandise.

Irony number one: the confidential informant believed that the true products were counterfeit and the counterfeit products were true products. It was clear to me that my client's products were the

counterfeits because there was a significant misspelling on the carton.

Irony number two: the client did not want to hear that his best-selling product was being counterfeited and distributed in a Florida marketplace. The client wanted to believe that his competitors' products were being counterfeited, and he had nothing to worry about. He was very wrong.

Reports then started from all around the country. Once we knew the product was being counterfeited and a word on the carton was misspelled, it was easy to spot in the marketplace.

Irony number three: most legitimate retailers do not want to handle counterfeit products and can become your best source of information. However, the investigation was stymied, because the perpetrators had covered their trail quite well, doing business using a nonexistent company's documents. Finally we received a break. Someone was offering this counterfeit product in Mexico, just across the border from San Diego. With the help of a highly competent Intellenet member, we were able to identify the seller and tracked him back into the USA.

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Irony number four: We attempted to present our problem to local law enforcement and you probably know the answer we received. We went from law enforcement agency to law enforcement agency attempting to get some cooperation and were told that they were far too busy with real crimes to become involved in the counterfeiting of a consumer product. Eventually, we made our way to the California Attorney General's office and had an audience with a special agent, who was getting ready to retire. As we explained our problem, he called a friend with U.S. Customs who joined the conversation. They looked at each other and said, "There must be a Customs violation in here somewhere" and took us to an assistant attorney general who also heard our plea for help.

Irony number five: the assistant attorney general asked how much were the damages that the client was suffering because of the counterfeit problem. The client responded, after doing a multiplication in his head that it was about \$200,000. With that, the assistant attorney general dismissed all thought of involvement. Being slightly better at mathematics than my client, I also did another multiplication and reached a damage estimate of \$2,000,000, only off by "0". A smile broke out on the assistant attorney general's face and she authorized the investigation. They don't work on cheap cases.

Then it became interesting, it was decided to approach the Mexican seller in an attempt to make a controlled buy. It was funny how things happen, but the Mexican seller happened to be stopped by a Customs Agent as he crossed the border, and was found with a large amount of marijuana. Then he thought it was wise for him to cooperate with the investigation and he identified his source, a naturalized Jordanian. It became more interesting at this point, as the case agent was wired for sound and he approached the Jordanian under controlled circumstances. Everything was working fine but the body wire started to short out and began burning the skin of the case agent.

Enough information was collected before the case agent had to terminate his adventure because of the pain from the burn, to get search warrants. When these warrants were executed, many thousands of counterfeit products were seized

along with records and computers. These were under the control of the Jordanian and two other people of Palestinian descent who were actively involved in selling any kind of counterfeit products that they could get their hands on.

Irony number six: this was 1997 and no one seemed to know how to search a computer nor did anybody think of seizing the cables and other peripherals that went with the computer. It apparently didn't matter at the time and the information lead investigators to yet other individuals who were believed to be the manufacturers of the counterfeit products.

A surveillance team observed the new suspects loading boxes in a large van and proceed down a California freeway. As luck would have it, they were stopped by the California Highway Patrol because the vehicle was obviously overloaded. The patrol officer found it necessary to thoroughly inspect the lading and reported back that it appeared to be several thousand cases of the suspected fragrances.

Investigation disclosed the location of a major warehouse, and as luck would have it, a fire inspector saw fit to conduct a thorough investigation of this warehouse, and later reported that it was filled with hazardous equipment, alcohol and the makings of the suspect fragrances.

Irony number seven: It is now Election Day and the investigators had been granted seven search warrants. A plan was made to execute these at one time on all the suspect locations, attempting to seize any and all evidence in the furtherance of the investigation. A total of 50 US Customs, California Department of Justice, Los Angeles police, Office of Naval intelligence, Immigration agents and the Los Angeles county sheriff's office members assembled in a schoolyard, dressed for battle. They were all equipped with flak jackets and semi automatic weapons and they were milling around the schoolyard which was at that moment being used as a polling place. Everyone had forgotten that it was Election Day and as the prospective voters approached this large gathering of fully armed men, their concern was alleviated when they were advised that we were "poll watchers." Always remember that on Election Day, things change.

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The warrants were executed properly, and the two principal manufacturers of counterfeit products were found with thousands of cases of the suspected fragrances, along with empty bottles, cartons and everything that is needed to make perfumes, including the formulas. They were also found with counterfeit purse making equipment and their records indicated that they were counterfeiting condoms and Similac, the baby food.

Irony number eight: The discovery that these individuals were counterfeiting baby formula so that young mothers may be feeding their children anything but the food they needed to survive and also counterfeiting condoms which were of such poor quality as to leak or break in use, really irritated the female investigators on the scene. They made their irritation known by word and deed and may have caused the perpetrators some emotional pain.

Irony number nine: The two individuals arrested were both Israelis who had two prior criminal convictions for counterfeiting and made it their business to deal with Palestinians as their point of distribution. This was certainly counter to the prevailing business mood in another part of the world. The needs of business transcend politics.

At the main location, the case agents seized weapons, police scanners, hundreds of credit cards, thousands of counterfeit sunglasses and evidence that they had counterfeited many other consumer products including other fine fragrances in the past. While the raid was taking place, a tractor-trailer approached the building in an attempt to make a delivery. The alert customs agent found the entire tractor-trailer was full of brand-name counterfeit sunglasses, much to the embarrassment and chagrin of the driver.

And in another location, thousands of empty bottles were seized along with the silk screens needed to put the labels on the bottles, along with evidence of future plans to counterfeit other products. When the occupants of this building recognized they were being surrounded by armed men, many of them hid in tiny cracks and crevices, as they were illegal aliens. We never did learn why the Office of Naval Intelligence Agents were present in the raid but the immigration agents

were kept busy.

Irony number ten: None of the police agencies had the space to store the quantity of evidence that was seized during the seven simultaneous raids, so a public storage room was rented using covert methods and properly locked and sealed to preserve the chain of evidence. The evidence became, in effect, the property of a government defense contractor who apparently had won a bid to dispose of all evidence after trial, especially contraband evidence such as counterfeit fragrances and sunglasses. Once they assumed custody, no one could approach the evidence for any reason.

Irony number Eleven: it was interesting that the police officers whom we approached initially to assist in the investigation now all wanted to be part of the solution and claim credit for the recovery of thousands of dollars worth of counterfeit products and the arrest of the perpetrators. So it is true that success has many fathers and failure is a bastard.

Irony number Twelve: it probably is no secret for you to realize that the one bad guy was sentenced to six months in prison with three years probation and a \$2000 fine and the other major perpetrator was sentenced to three years probation followed by six months home detention with electronic monitoring.

It was a fun case.

Counterfeiting Of Goods: The Risks and Links To Terrorist Funding

**Jeffrey A. Williams, CPP
President and Managing Director
Orion Support Incorporated (OSI)
Manila, Philippines**

In a statement before the House Committee on International Relations in U.S. Congress on July 16, 2003, Mr. Ronald K. Noble, Secretary General for Interpol, advised that the link between organized crime groups and counterfeit goods is well established. However, he also sounded the alarm that Intellectual Property Crime (IPC) is becoming the preferred method of funding for a number of terrorist groups.

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"And there's evidence that it's increasing," said Noble, adding "it was almost inevitable that terrorists would follow organized crime into the counterfeiting business. It's a low-risk, high-profit crime area that for most governments and most police forces is not a high priority. And therefore criminals are more likely to want to get involved in this area rather than drug trafficking. Right now we're at the tip of the iceberg," Noble told The Associated Press in an interview at the First Global Congress on Combating Counterfeiting. "If law enforcement and governments focused on it more, we'd find more evidence of it."

Mr. Noble goes on to define IPC as the counterfeiting or pirating of goods for sale where the consent of the rights holder has not been obtained. He defined terrorist financing as the generation of funds via licit or illicit means that are then remitted to a terrorist organization or its front organization via formal or informal financial channels. These funds may be used for either the running costs of the organization or to carry out attacks.

Approximately 10% of spending goes for operational matters, while 90% is used to maintain the infrastructure of the network, including payments to other groups to support them. Such payments include money to guarantee their protection in Afghanistan and the Sudan; as well as to increase al-Qaeda's influence throughout the Middle East and the rest of the world. However, terrorist funding is difficult to investigate due to the complex flows of money often in cash form and often laundered. This is facilitated by complicated associations of individuals through which the money transits.

The links between IPC and terrorist financing can be categorized as follows:

Direct involvement is where the relevant terrorist group is implicated in the production, distribution or sale of counterfeit goods and remits a significant proportion of those funds for the activities of the group.

Indirect involvement is where sympathizers or militants are involved in IPC and remit some of the

funds, knowingly to terrorist groups via third parties.

According to Kathleen Millar, "Financing Terror, Profits from Counterfeit Goods Pay for Attacks," in order to survive, a terrorist organization must first develop and maintain reliable and low key sources of funding. Behind the suicide bombers, hijackers and gunmen stand "criminal entrepreneurs and financiers in suits who understand the best way to bankroll Armageddon is through the capitalist system." Terrorist organizations are attracted to counterfeiting and piracy because it is a lucrative business, but also because it allows terrorists to remain relatively anonymous. Counterfeiting and piracy rings often operate as cash enterprises. They lease manufacturing equipment from third parties and generally do not maintain reliable paperwork or business records. Upon suspicion of detection, terrorist counterfeiters can move merchandise, hide assets and equipment, switch manufacturing locations, destroy evidence, or simply disappear without leaving a paper trail. And, most importantly, any profits made in this type of underground market are obviously difficult to trace.

Trade in counterfeit or pirated goods over the past 20 years has grown exponentially. In 1982, the counterfeiting industry drained an estimated \$5.5 billion dollars from the global economy. In 1996, this figure jumped to an estimated \$200 billion. Today, the FBI, as well as U.S. Customs and Border Agents approximate the figure to range between \$450 – 500 billion per year. The Business Software Alliance and the U.S. automobile industry are estimated to be losing close to \$15 billion dollars annually each! According to Carrutu International PLC, a leading intellectual property rights investigative firm based in the U.K., the global counterfeit market accounts for 9 percent of world trade and likely will double in the next two to three years. (Bank robberies in the United States, by contrast, involve less than \$70 million per year, but seem to garner more public attention and more law enforcement resources.)

In general, law enforcement does not treat IPC as a high priority crime. And, it does not always investigate IPC cases. Investigations, when initiated, often tend to be seizure-based and do not

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extend to following onward flows of money. Even if law enforcement were to follow onward flows of money, given the high level of cash-based transactions involved, it is difficult to establish with precision the end destination of the financial flows. In relation to private industry enforcement bodies, a number of whom conduct intelligence gathering operations, generally, money trails are not of interest as the primary task is to eradicate counterfeit production and seize counterfeit goods.

Nonetheless, Interpol does not believe an investigation into Intellectual Property Crime is over when there is a seizure of counterfeit or pirated goods. They believe that further work needs to be done to trace the proceeds and to establish links if possible with groups benefiting from these funds. Law enforcement agencies have to recognize that Intellectual Property Crime is not a victimless crime. Because of the growing evidence that terrorist groups sometimes fund their activities using the proceeds, it must be seen as a very serious crime with important implications for public safety and security.

Mr. James Moody, former Chief of the Federal Bureau of Investigation's Organized Crime Division declared in 2001 that counterfeiting would become "the crime of the 21st century."

The counterfeit traders with whom most people come into contact are small-scale operators or street vendors. However, such vendors are only the front end of much wider and more sophisticated networks. Although the term "organized crime" should be used with caution in describing the counterfeiting industry, Interpol states that "extensive evidence" is now available which demonstrates that organized crime syndicates, and to a lesser extent, a number of terrorist groups are involved in planning and committing intellectual property related crimes."

Carrutu International PLC has repeatedly warned that the innocent purchases from Internet sites and street markets of counterfeit products ranging from knockoffs of Nike and Tommy Hilfiger merchandise to electrical parts are funding terrorist and criminal organizations, including al-Qaeda, the Mafia and the Irish Republican Army. Mr. Noble (Interpol) agrees and further identifies Hezbollah, the Basque

ETA, Chinese Triad gangs, the Japanese Yakuza crime syndicate, the Russian Mafia and the drug cartels as additional recipients of profits from counterfeiting. The International Anti-Counterfeiting Coalition (IACC) Web site advises that terrorist organizations are using the sale of fake goods to raise and launder money. They specifically state that, "Recovered al-Qaeda terrorist training manuals have revealed that the organization recommends the sale of fake goods as one means to raise funds to support terrorist operations."

In general, al-Qaeda and affiliated groups benefit from funds raised by sympathizers. This may include funds originating in either licit or illicit activities. One estimate is that over a ten year period, al-Qaeda received between \$300 million and \$500 million, averaging US\$30 to US\$50 million a year. The September 11 attacks have been estimated as costing less than US\$500,000 to fund – a little more than \$26,000 per terrorist and certainly not a large or unattainable amount of money. Based on the aforementioned figures, one successful large scale intellectual property crime could potentially fund multiple terrorist attacks. Sources for funds depend on the needs of the group and its capacity to generate funds. A group like the FARC in Colombia obviously needs to generate large amounts of money in order to support a large and relatively expensive infrastructure. In contrast, some paramilitary groups in Northern Ireland have financial requirements under USD\$1 million per annum.

Mr. Noble cited the seizure of \$1.2 million worth of counterfeit German brake pads and shock absorbers in Lebanon several years ago. A subsequent inquiry found that profits were destined for supporters of Hezbollah, considered a terrorist organization by the U.S. government. Noble added that some supporters of al-Qaeda have been found with huge amounts of counterfeit items. "If you find one al-Qaeda operative with significant amounts of counterfeit goods, it's like finding one roach or one rat in your house," he said. "It should be enough to draw your attention to it."

The L.A. Times reported that a Norwegian plane crash in 1989 that killed 55 people resulted, in

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part, from substandard (counterfeit) shear bolts and sleeves of an unknown origin. The operational life of counterfeit bearing seal spacers removed from a United Airlines plane were found to be 600 hours, while the genuine parts had an operational life of 20,000 hours. The fake parts came complete with fake boxes, labels and paperwork and were only discovered because of a vigilant airline mechanic.

In August 1997, then Inspector General of the U.S. Department of Transportation, Mary Schiavo, admitted that counterfeit aircraft parts had been found on Air Force One (the plane used by the President of the United States). The Federal Aviation Authority, or FAA, estimates that 2% of the 26 million airline parts installed each year are counterfeit (that equals 520,000 parts!)

Following the bombing of the World Trade Center in 1993, the Federal Bureau of Investigation (FBI) found links to IPC and sentenced Sheik Omar Abdul Rahman to 240 years in prison for plotting to bomb the World Trade Center. The FBI believes that the operation was partly financed by the sale of counterfeit clothing. In 1996, the FBI confiscated 100,000 T-shirts bearing fake and unauthorized Nike "swoosh" and/or Olympic logos that were intended to be sold at the 1996 summer Olympic Games in Atlanta. The operation generated millions of dollars and was run by the followers of Sheik Rahman.

Specific Examples

The Interpol General Secretariat cites the following examples of the association between intellectual property crime and terrorist financing:

Northern Ireland

In Northern Ireland, the counterfeit products market is estimated to cost the economy in excess of US\$167 million. In 2002, the police seized in excess of US\$11 million in counterfeit products. It is known that paramilitary groups are involved in IPC, including counterfeit cigarette trafficking. It is unknown how much of the money generated by these counterfeiting operations goes to terrorist groups and how much is retained as criminal profit.

Paramilitary involvement in IPC in Northern Ireland is through their control of the markets where many counterfeit goods are sold.

Kosovo

An example similar to the situation in Northern Ireland is in the United Nations-administered province of Kosovo. A significant proportion of consumer goods (CDs, DVDs, clothes, shoes, cigarettes and computer software) available for sale are counterfeit. The sale of counterfeit goods occurs openly and there is limited enforcement against counterfeit products due to significant legal loopholes. In Kosovo, there is a long-standing relationship between criminal organizations and local ethnic-Albanian extremist groups. This relationship is based on family or social ties. It is suspected that funds generated from IPC benefit both criminal organizations and extremist groups.

Chechen Separatists

Interpol is aware of a case in 2000 in Russia, where Chechen organized crime groups and terrorist organizations were benefiting from counterfeit goods manufacturing and trafficking. Specifically, in 2000, a joint operation between Russian law-enforcement agencies and private industry resulted in the break-up of a CD manufacturing plant. According to the police officials involved, this counterfeit CD plant was a source of financing for Chechen separatists. The CD plant was run by Chechen organized crime which then remitted funds to Chechen rebels. The FSB (Russian Federal Security Service) estimated that the average monthly earnings of the criminal organization are estimated to have been US\$500,000—700,000. A number of explosives and arms were also confiscated by the police during raids on the residences of the suspects.

Tax Free Zones

According to the International AntiCounterfeiting Coalition (IACC) in a report on Special 301 Recommendations to the U.S. Trade Representative in February, 2004, special economic (tax) free-trade zones around the world are being exploited by IPC criminals to move counterfeit

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goods. Between the conveyances used to move goods and the warehouses in free-trade zones storing illegal products the free-trade zones are areas where too many governments take a hands-off approach to illegal conduct. The IACC cites a number of worldwide examples to include the Philippines. They state that in a number of free-trade zones and "bonded warehouses" in the Philippines, underground CD production lines are often heavily secured sites equipped with hidden cameras for early detection and surveillance purposes. They further stated that syndicates move equipment piece by piece to avoid detection, as cited by "The Manila Times" in January 2003. Additionally, it is suspected that large quantities of counterfeit cigarettes are moved through these free trade zones by organized crime. And, some of the proceeds from this intellectual property crime could be used to fund various terrorist groups without the knowledge of the organized syndicates behind it.

The Triple Frontier/Tri-border Region

In "Terrorist and Organized Crime Groups in the Tri-Border Area," authored by Mr. Rex Hudson, he cites another specific example detailing the link between counterfeiting and terrorism that deserves a greater degree of attention. The example concerns the infamous tri-border region of South America where the countries of Brazil, Argentina and Paraguay meet in an area referred to as the Triple Frontier. For nearly three decades, the Triple Frontier has served as a friendly operations center for international "smugglers, counterfeiters and tax dodgers" and has earned a reputation for being one of the most lawless places on the planet. Inhabitants of and visitors to the region move with relative ease among the three countries as they attempt to evade what little official authority exists in the region. Despite repeated and persistent industry complaints, counterfeit and pirated products literally saturate the region, especially in the Paraguayan border town of Ciudad del Este.

Add to these problems, the fact that, according to Jeffrey Goldberg, "In the Party of God: Hezbollah Sets Up Operations in South America," American intelligence officials now believe the region is also a hotbed for Middle Eastern terrorist groups like al-Qaeda, Islamic Jihad, Hezbollah and Hamas. One

intelligence official reported that some of the estimated 30,000 Muslims in the region held celebrations on Sept. 11, 2001, as well as on the one year anniversary date. In early 2003 in Miami, the Paraguayan consul was arrested for selling three hundred passports to individuals, including some terrorist suspects from the Middle East.

One important fund raising figure for Hezbollah, Ali Khalil Mehri, was arrested by Paraguayan authorities on February 25, 2000, in the Tri-Border area for violating intellectual property laws, to include the manufacture and distribution of counterfeit CDs. Seized from his apartment were guns, pirated discs, film footage of terrorist attacks, interviews with suicide bombers and documents showing money transfers worth over USD\$700,000.00.

Hezbollah

Interpol is aware of a number of cases of IPC-related activity and terrorist funding in South America. These cases involve ethnic Lebanese who are involved in the remittance of funds to Hezbollah. Interpol's information suggests that these persons are involved in the distribution and sale of counterfeit goods, not in the manufacturing or fabrication of counterfeit goods. It is suspected that most counterfeit manufacturing and fabrication is dominated by organized crime in the Triple Frontier/Tri-border Region.

Funds generated from IPC may be remitted to Hezbollah using the following modus operandi. Counterfeit goods produced in Europe are sent to free-trade zones in South America by a group of Lebanese criminals sympathetic to Hezbollah. The goods are then smuggled into a third country, to avoid import duties, where they are sold via a network of sympathizers and militants originating in the Middle East. An unknown amount of the money generated through this activity is suspected to be remitted to Hezbollah.

In February 2000, an individual was arrested in South America for piracy and suspected fundraising for Hezbollah. The individual sold pirated music CDs, Sega, Sony and Nintendo game discs to fund a Hezbollah-related organization. Among the discs

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recovered were discs containing images and short films of terrorist attacks and interviews with suicide bombers. The discs were allegedly used as propaganda to generate funds for Hezbollah. Interpol is in possession of some of these films.

Another individual was arrested for his alleged ties with the Hezbollah in South America in June 2002 after evading arrest in October 2001. The individual was wanted for tax evasion and the collection and remittance of funds to extremist organizations. An alleged IPC connection is stated in open sources. Law enforcement sources also indicated that numerous letters from organizations suspected of being associated with Hezbollah in Lebanon were found thanking the individual for financial contributions.

In February, 2002, Fox News reported that Mohamad Hammoud was sentenced to 155 years in prison for helping to lead a cigarette smuggling operation out of North Carolina that funneled money to Hezbollah. Over the course of 18 months, he smuggled over 8 million dollars of counterfeit cigarettes which were manufactured in China for USD\$2.00 per carton, and sold for up to USD\$70 per carton in Michigan. In June 2002, Hammoud was additionally convicted for providing aid to a terrorist organization. The indictment papers surrounding the case stated that Hezbollah officials in Lebanon asked cell members to purchase equipment such as "computers, night vision equipment, mine-detection devices, global-positioning devices and advanced aircraft analysis" with the funding from Hammoud.

Al-Qaeda

Several counterfeiting cases that have been reported in the media where there were alleged connections to al-Qaeda include an investigation into a shipment of fake goods from Dubai to Copenhagen, Denmark. This transnational investigation involved agencies from three countries—Denmark, the United Kingdom and the United States—and suggested that al-Qaeda may have indirectly obtained financing through the smuggled counterfeit goods. Danish customs intercepted a container of counterfeit shampoos, creams, cologne and perfume. The sender of the counterfeit goods was allegedly a member of al-

Qaeda. It is difficult to know whether the funds from this traffic went directly to al-Qaeda or whether only a part of them were remitted. In general, it is possible that funds generated through IPC are remitted to al-Qaeda indirectly through zakat-based (a religious duty to give money) giving. Given the cash-based nature of this giving, it is difficult to establish the provenance of the funds.

According to James Nurton, "Why Crime is Not So Harmless," an intellectual property crimes search and seizure operation in early 2002 on a souvenir shop in mid-town Manhattan led to the seizure of a suitcase full of counterfeit watches and the discovery of a flight manual for Boeing 767s, some containing handwritten notes in Arabic. A similar raid shortly thereafter on a counterfeit handbag shop in New York uncovered faxes relating to the purchase of bridge inspection equipment. Two weeks after that raid, another raid revealed fake drivers' licenses and lists of suspected al-Qaeda terrorists – including names of some workers in the handbag shop that had just been raided.

Potential Means for a Terrorist Attack

In addition to the concern about counterfeiting organizations financially supporting terrorist cells, say authorities, they also are worried about the use of counterfeit products as a potential means of attacking the United States. An International AntiCounterfeiting Coalition (IACC) White Paper published in January 2005 advises that the frightening potential exists that terrorists could use the commission of the crime itself as a means of attack. To gain an appreciation for the potential harm factor, one need only consider the possible use of counterfeit pharmaceuticals that, in place of proper ingredients, actually contain deadly chemicals, poisons or biological toxins.

With the increasing number of pharmaceuticals coming from sources that are often beyond the reach of U.S. regulators at both the federal and state levels, it would certainly not be difficult for determined terrorists to slip such deadly products into the stream of commerce. The internet and the relatively small, but largely unchecked, secondary wholesale distribution markets are two examples of essentially unregulated distribution channels where

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a pharmaceutical attack of this nature could be rather easily targeted.

Consider the story of a 35-year old woman who purchased and consumed a diet drug from Mexico. She suffered multiple organ failure and eventually died. Whether or not this was a terrorist act, the woman is one of several dozen Americans known to have died from taking counterfeit drugs, according to the U.S. Food and Drug Administration.

The World Health Organization, WHO, estimates that 50 to 60 percent of all drugs sold in parts of Africa and 25% or more of drugs sold in Mexico now are counterfeit, which may be partly due to the fact that Mexico allows its pharmacists to work without formal training and does not require prescriptions. A survey conducted by the Nigerian Institute of Pharmaceutical Research revealed that 80 percent of drugs in the major pharmacy stores in Lagos were fake or counterfeit. And according to the Shenzhen Evening News (a Chinese government owned newspaper), approximately 192,000 people died in China in 2001 because of fake drugs. On average, WHO estimates that 10 percent of all medicines currently being sold worldwide are fakes. They further advise that 16% of counterfeit drugs contain the wrong ingredients, 17% contain incorrect amounts of the proper ingredients and 60%+ have no active ingredients whatsoever.

Other studies have suggested that nearly one-quarter of "e-pharmacies" selling medicines on the Internet are illegal, and many of the medicines they sell are either outright fakes or repackaged products that outlasted their original shelf life. Some of the Internet pharmacies, for example, are selling "sugar pills" as drugs to lower cholesterol. Just because a product is being sold under a brand name does not mean that it is as advertised. In February 2004, the U.S. Food and Drug Administration (FDA) warned the public about internet sites based overseas that were selling counterfeit contraceptive patches that contained no active ingredients and provided no protection whatsoever against pregnancy. And in the 1980s, one million counterfeit birth control pills were sold that caused internal bleeding in some women.

In the event of such an attack, it could take days or perhaps weeks for the problems to come to light. Any efforts at containment would be severely complicated if the tainted drugs were distributed and sold over a wide geographic area. As it stands now, counterfeit drugs have already been responsible for numerous deaths and injuries. But even without deadly substances at their disposal and even without the expertise necessary to work with such poisons, terrorists could still pose a deadly threat. They could intentionally mislabel bottles with virtually indistinguishable counterfeit labels that contain erroneous information about the dosage or even type of drug contained therein.

The use of false bar codes or lot numbers would make the medicine difficult to track and its origins or source nearly impossible to trace. A terrorist group could also sell fake pharmaceuticals that contain no active ingredient whatsoever and thus deprive takers of the expected benefits. Indeed, the terrorists wouldn't even need to enter the United States to carry out the attack. They could ship large quantities of tainted medicines into the country, deliver them over the internet via the U.S. mail or package delivery companies, or unload the dangerous drugs into the pharmaceutical distribution facilities in northern Mexico for sale to the large numbers of Americans which visit and purchase the discounted medicines. This same scenario could also hold true in countries such as the Philippines that were closely aligned with the United States in the war on Iraq and where oftentimes prescriptions are not required to purchase medicines.

Of course, this speculative analysis only covers the pharmaceutical industry. Automobile and airplane parts, food items, cosmetics and shampoo present other vulnerable targets and all new sets of issues and questions. However, as with many other aspects of the post 9/11 world, the harm that could be inflicted via intellectual property related crimes simply cannot be ignored or dismissed.

There are enough examples now of the funding of terrorist groups from intellectual property crime for us to worry about the threat to public safety.

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Future Trends

In a paper approved for publication by the U.S. National Foreign Intelligence Board entitled "Global Trends 2015: A Dialogue about the Future with Nongovernmental Experts," it is stated that between now and 2015 terrorist attacks will become increasingly sophisticated and designed to achieve mass casualties. And, they expect the trend toward greater lethality in terrorist attacks to continue.

Chemical and biological threats to the United States and its Allies will become more widespread as such capabilities are easier to develop, hide and deploy than missiles armed with WMD. Earlier this year, it is alleged that the Philippine government seized Jemaah Islamiyah (JI) documents in Cotabato, Mindanao that dealt with chemical and biological warfare and there was evidence that experiments were taking place on farm animals in the area. The JI is an Indonesian terrorist group alleged to be aligned with al-Qaeda.

Global Trends 2015 goes on to state that the trend away from state-supported political terrorism and toward more diverse, free-wheeling, transnational networks—enabled by information technology—will continue. Some of the states that actively sponsor terrorism or terrorist groups today may decrease or even cease their support by 2015 as a result of regime changes, rapprochement with neighbors, or the conclusion that terrorism has become counterproductive.

States with poor governance, ethnic, cultural, or religious tensions, weak economies, and porous borders will be prime breeding grounds for transnational networks seeking safe havens for terrorism. It has already been established that some terrorist groups are receiving funding from IPC. Such sources of funding could originate from the manufacture or importation/distribution of counterfeit goods from those areas that offer the greatest degree of protection within those countries, such as special economic (tax) free zones where governments historically take a hands-off approach to illegal conduct such as Intellectual Property Crime.

Are we unwittingly supporting terrorist operations through the purchase of counterfeit goods, especially goods such as counterfeit CDs or DVDs, a local industry where many of those involved have strong ties to the Middle East and possibly interests inimical to those of the local and U.S. governments?

Sound incredible? So were the plans to fly commercial airliners into the Twin Towers in New York City that were seized in the Philippines in 1995 during an operation targeting Ramsey Yousef.....until six years later!

Maynard and his neighbor were talking. "How you been feeling lately?" asked the neighbor. "Oh, I been kind of sickly," replied Maynard. "Doc Jones gave me some pills to take every day with a little corn whiskey." "Are you feelin' any better now?" "Not too bad, considerin' I'm two weeks behind on the pills and five weeks ahead on the whiskey."

Product Diversion
Reggie Montgomery
RJ Montgomery Associates
Allendale, New Jersey

(Editor's Note: The following is Chapter 19 extracted from Mr. Montgomery's book "Corporate Investigations, 2d Edition.)

19.1 Introduction

Product diversion, by definition, refers to products sold by the manufacturer, which are distributed into markets other than originally intended by contract, law or regulation. This enables third parties to undercut the intended price of the product to the public and reap huge profits. This international scheme hinges on an industry practice in which manufacturers set up different prices for the same product. It is a way to break into new markets and expand name recognition outside the United States. Because of tax incentives and other cost savings, American businesses can sell their

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products to overseas distributors at dramatically lower prices than those paid by distributors based in the United States. When products are diverted, those goods are illegally rerouted by a third party back to American markets.

The hierarchy of the pricing of products is generally familiar to most Americans. It is apparent in everyday life. One store will have a pair of designer jeans for \$65.00. That same pair of jeans can be purchased at a discount store for \$30.00 and at a flea market for \$15.00. Sometimes this reflects nothing more than a legal pricing of merchandise that has been bought from the manufacturer at a wholesale price and sold at various discounts depending on the necessary overhead.

However, there are several tiers of wholesale. That same product might be purchased as a promotional or institutional item at a special rate, lower than the wholesale price available to the regular retail market. This allows special rates to large purchasers of merchandise who are promoting a particular product.

19.2 Diversion Is Not Theft

Most investigators have had exposure to theft of product and tend to confuse the two situations. When is it diversion and when is it theft? The answer is simple. Theft is the unauthorized taking and diversion is the unauthorized distribution achieved by misrepresentation. An example of theft can be seen in an investigation conducted several years ago.

A large manufacturer of designer leather handbags was known for its exclusive and costly product. The company did not sell to discounters. They maintained the quality and exclusivity of their bags because of this limited, but highly priced market. Someone happened to purchase a bag with the designer label from a street vendor. To all appearances it was an identical bag. In fact, when compared with a sample from Bloomingdales' showroom floor, it was exactly the same. Upon this discovery, the manufacturer initiated an investigation. It involved the placing of an undercover operative inside the workroom of a company that was subcontracted to assemble and

finish the handbags. The operative discovered that the theft was actually an internal problem being perpetrated by one of the senior management personnel in collusion with a subcontractor. Records indicated that only three bags could be cut from a piece of leather. The remainder was written off as scrap. In reality, if the patterns were laid out carefully, an extra two bags could be cut from each piece of leather. This allowed thousands of additional bags to be made, right in the subcontractor's own workroom. The overage was shipped to wholesalers who undercut the product and sold it through vendors on city street corners. In fact, it was the same bag and of the same quality. This is theft.

19.3 How Diversion Occurs

Diversion will most likely occur in the areas of:

- Export sales
- Promotional offers
- Regional promotions
- Samples, trial and travel packs
- Hotel amenities
- Charitable donations
- U.S. (and foreign) government sales
- Destruction of excess merchandise

A classic example is an investigation that was successfully conducted on a dental supply company. For purposes of anonymity and client confidentiality it shall be referred to here as PC Dental Supply. This is a company that sells products to dentists and institutions where dental work is performed. In May, PC Dental negotiated a special promotional package with ABC Hygiene Company to distribute small bottles (3 oz.) of ABC's most popular mouthwash. The promotion stated that for every \$500 in mouthwash sales, the institution would be given a free case of mouthwash to be provided to patients at the time of their yearly checkup. Everything looked legitimate until the records began to indicate that PC Dental had purchased in excess of 100,000 cases of mouthwash in a four-month period. That's over a million small bottles. The original contract allowed ABC's representatives (in this instance, the investigators) to review the records of PC Dental.

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This is a key factor in the ability of an investigator to prove effective for his client. When products are purchased according to these specific discount schedules, there is a contract negotiated between the manufacturer and the purchaser. This contract gives the specific right for the manufacturer, or his representative, to review all records related to the purchase and distribution of the discounted product.

The investigators were, therefore, able to review and compare shipping, receiving and payment records. A large portion of the mouthwash order had allegedly been shipped to a hospital distributor in California. With the help of a local investigator, the distributor's receiving clerk and warehousemen were interviewed. They swore that they never saw, received or unloaded this product. There were no records of buying the product and no one had ever heard of PC Dental. Ultimately, admissions were obtained from the parties involved in the diversion. Armed with the documents provided by the diverter in the paper trail, information was uncovered proving that the intended party never received the merchandise.

The culprits "rolled over" when interviewed and their statements were verified by polygraph. The product was actually sold to a wholesaler in Brooklyn and then to a large distributor in Maryland. The Brooklyn wholesaler originated and financed the scheme.

This was a diversion case. It was a contractual matter because PC Dental misrepresented the stated and intended use of the product from its contractual agreement, and it was also a fraud. In addition, because it involved more than one party, it was a conspiracy to commit fraud. Because PC Dental was located in New Jersey, the institution in California, the wholesaler in Brooklyn and the distributor, who ultimately received the product, in Maryland, it became an interstate situation, and thus a RICO charge. The corporate client was interested only in recouping the money they had lost because of product underselling. By invoking the contractual agreement, which allowed for treble damages and the payment of the difference between the very low wholesale price and the actual retail price to the consumer, they were able to recover their lost profit. A negotiated settlement

was agreed upon. This case exemplifies the difference in theft and diversion. It also is indicative of the various consequences of diversion in the legal world.

19.4 Diversion versus Other Forms of Product Abuse

It can be said that diversion is unauthorized distribution achieved by misrepresentation. Diversion is a result of established contractual relationships between the manufacturer and the distributor. When that product is purchased at one price but diverted for a separate and unintended use, it falls within the scope of the product diversion case. Since the concept of diversion is so specific and generally not understood by the public, it is often confused with several other areas of product abuse:

Counterfeiting is the making of an item to look like the original. Generally, it is of lesser quality.

Pirating is the theft of product, such as the bootlegging of HBO or pay-per-view cable programs that are normally sold (such as boxing matches and soccer matches that sell exclusively through television vendors).

Trademark infringement involves the use of a name or label, which closely approximates that of the original, authorized manufacturer. We have all seen Cucci, instead of Gucci, and initialed designer clothing with a similar logo but slightly different initials.

Gray market also deals with the sale of American branded products which are manufactured for less in foreign countries and sold in the United States for lower than retail prices. It is not uncommon for items such as shampoo, which is made in Mexico (where the peso is grossly devalued), to be purchased from that source and brought into the U.S. to be sold in Spanish-speaking neighborhoods. The item is purchased for less, sold for less and has the added value of being labeled in Spanish.

These non-diversion forms of product abuse need to be understood, so that the investigator learning

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about the intricacies of diversion will not confuse them.

19.5 The Four Areas of Diversion

Concentration in the remainder of this chapter will be on four specific areas where product intended for one market is diverted to another: (1) charity, (2) closeout or counterfeit dating, (3) market diversion, and (4) dated product.

A. Charity

Charity diversions are not only unethical but illegal as well. A prime example of this type of diversion can be seen in the area of comestibles. Food packages are coded uniquely by manufacturers, and each item has a "shelf life" (a date after which the product should not be sold; frequently product safety is an issue, but it is also used to insure product flow and turnover). When its shelf life has expired, the product is not necessarily unfit for consumption (in fact, it is generally good for a year or more after that date—except, of course, for milk and dairy products). Therefore, when a product has come within a month or so of its shelf life, the retail store (supermarket) will remove it from the shelves. The store receives credit for this unused product from the manufacturer, so there is no loss to them. In the name of good will these products are often shipped to local food banks where they can be purchased at minimal prices by homeless shelters and state subsidized nursery facilities.

The author was once retained in a case where an individual was purchasing great amounts of grocery products from the food bank, alleging to be supplying a daycare center. In fact, what he was doing was storing the product in two rooms of the center (limiting the space for the children) and selling the product on weekends at local flea markets for his own profit. This is a classic case of diversion.

B. Closeout or counterfeit dating

Closeout or counterfeit dating involves these same "shelf life" dates. Often items are packaged in cases and the expiration date for use is stamped all over the outside of the carton. There are highly

sophisticated syndicates that specialize in "repackaging" product and stamping new, later expiration dates on the outside. Therefore, they are selling outdated products which appear to be timely. When the closeout dates are replaced by new dates on original packaging by innovative diverters, this is the diversion of product from its intended use. In most cases, this product would be destined for destruction.

C. Market diversion

Market diversion is common. It can be observed simply by walking through the ever-growing weekend flea market or observing product sold by street vendors.

A recent case involved the exposure of a large diverter who was purchasing merchandise by the truckload at institutional promotional prices and selling that same product through regular retail stores. The item was cough syrup. The stated, contractual use of this product was to place a packet of cough syrup in college kits to be given to new students as promotional merchandise. (Similar "kits" are given to hospital patients and generally include a miniature toothbrush, toothpaste, hand cream and talcum powder.) Because of the stated use, the buyer/diverter was given a large discount off of the normal wholesale cost for these items. The buyer/diverter ordered forty tractor-trailer loads of this cough syrup. Simple arithmetic would dictate that there was enough cough syrup for every man, woman and child in the United States to stem a sore throat for a year! The quantity raised corporate eyebrows and an investigation ensued. Surveillance and investigation revealed that the cough syrup was being repackaged and sold directly to retail channels, tripling the normal profit for the buyer/diverter.

D. Dated product

Dated product, as previously explained, does not necessarily become unusable after the expiration date has lapsed. One has but to walk through a flea market to note a large variety of items generally seen on supermarket shelves for sale at extraordinarily low prices. A closer inspection of items such as pharmaceutical products (Tylenol®),

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aspirin, Neosporin® cream, etc.) will reveal that the bottles have dates that have expired. The products were most likely taken off the shelves with intent to be either returned to the manufacturer or sent to another venue by the manufacturer for sale at a lesser price. Their presence in flea markets is indicative of some sort of fraud to the consumer that also lessens the value of the product to the manufacturer.

While the traditional methods of surveillance (undercover operatives, taking witness statements and interviews) are often useful, the diverter maintains the real evidence himself—the paper trail of his own records. Comparing original contracts and “use” statements (in which the intended use of the product is clearly spelled out) of the diverter against those of the manufacturer is the starting point. Next, the bills of sale from the manufacturer generally provide the dates and quantities purchased and the responsible parties. Shipping orders and bills of lading should be examined and compared to warehouse receipts from receiving clerks. Checks paid for transportation of merchandise are also compared. Invoices reflecting to whom merchandise is sold and method of shipment are scrutinized. It becomes a numbers game and the numbers sometimes just don’t match up.

On Wednesday, July 26, 1995, a news release was issued by First Assistant U.S. Attorney Robert J. Cleary: “Three Charged for Roles in Alleged ‘False Export’ Diversion Schemes That Cost Four American Manufacturers Millions in Losses.” The article provided information on three individuals (Kotbey Mohamed Kotbey, Mary Ellen Kitler and Urs Brunschweiler) charged in a 122-count indictment by a Newark, N.J., federal grand jury. The counts included conspiracy, wire fraud, mail fraud, interstate transportation of goods obtained by fraud, issuing false bills of lading, and money laundering.

It continued, stating that--

U.S. manufacturers of branded consumer products often export their products to foreign customers for sale overseas, and commonly grant the export customer a discount of up to 50 percent below U.S. prices. Manufacturers are willing to grant such

steep discounts in order to open new markets and expand worldwide sales. The great disparity between domestic and export wholesale prices for finished U.S. products creates the opportunity for the fraud known as “product diversion,” according to court documents in a related case . . . In all four schemes Kotbey was able to obtain lower prices by falsely claiming the products would be distributed in Eastern Europe or the Middle East. Instead, Kotbey sold the products for distribution in the United States and did not distribute them in foreign countries. In two of the four schemes, Kotbey claimed the goods would be donated to the poor. In one of the four schemes, Kotbey claimed the goods would be distributed to military organizations for humanitarian purposes, the Indictment alleges. Through these schemes (he) obtained blood sugar monitoring devices used by diabetics, popular Nestle products such as Taster’s Choice Coffee and Nestle’s Quick, and prescription drugs. During the sentencing of an alleged coconspirator, it was established that Nestle alone lost millions of dollars as a result of this scheme.

Additional charges were explained:

According to the indictment, Brunschweiler supplied bogus export documents to Johnson & Johnson, making it appear that the goods purchased were shipped overseas. Brunschweiler was arrested in France on July 12, upon a warrant issued by U.S. Magistrate Judge Dennis M. Cavanaugh, also in Newark. Brunschweiler is being detained in a French jail pending extradition proceedings to the United States. The U.S. Department of State is expected to present a formal extradition request to French authorities sometime in the next several weeks . . .

The news release makes many valid points, echoing the experiences I have encountered while investigating product diversion cases for the private sector:

[G]oods sold for export (which) never actually leave the United States, cause two distinct harms.

- First, there is a monetary loss to the Government through the payment of export incentives on goods destined for foreign countries. For example, in the

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Indictment returned yesterday, Nestle relied on false shipping documents allegedly provided by Kotbey to purchase refined sugar through a U.S. Agriculture Department (USDA) program that allows U.S. manufacturers to purchase sugar below U.S. market prices.

- Second, essential regulatory procedures are compromised. For example, medical devices and prescription drugs sold for export, but distributed in the United States, cause regulatory problems for the Food and Drug Administration (FDA). Because the FDA requires U.S. pharmaceutical companies to maintain accurate records of drug distributions to aid recall in the event of defective, adulterated, or tampered products, it is particularly concerned about the public health implications of schemes involving diverted prescription drugs. . . .

Although the pharmaceutical products involved in this case are not known to have been mishandled, the diversion of these products violates the strict FDA record keeping requirements regarding sales of prescription drugs, which brings into question the ability of pharmaceutical manufacturers to recall specific lots of drugs, and subjects the drug products to undocumented and potentially unsafe storage and distribution methods. . . .

19.6 Indicators of Diversion

Word of mouth. Frequently salespersons or even consumers provide information about merchandise being sold for cheaper prices.

The numbers. Figures indicate that sales are down, yet there is an increasing volume of the company product available in a given demographic area.

Complaints. Customers call with the irritating news that they have competitors within their sales area undercutting their price structure.

Physical evidence. Stores, which are not known to carry the product line, are seen to stock and advertise the merchandise at ridiculously low prices. New markets are opened which did not carry the product line previously.

Ineffective marketing. Promotional sales do not result in increased profits.

Profits decline. Merchandise is "on the street" in volume, but the bottom line is not indicative of its sale.

19.7 The Role of the Investigator

A. Identify the diversion

This is generally the role of the company. Once the indicators have been observed, management should start pooling its resources to determine the extent of the problem. However, the investigator can become involved at this early stage to organize the proper investigation and obtain information from various sources known to management. Look for unusual shipping requests, excessively large volumes of merchandise going to geographic locations that could not handle the market glut, and so forth. Examining the company's own sales records is perhaps the most logical and effective starting place.

B. Tracking suspicious sales

Internal security can secretly mark product in a particular manner which will allow them to determine if merchandise allegedly destined for overseas finds its way to store shelves in the United States. Import databases maintained for cargo vessels, airplane exports, etc, are a source of information, which can be used to verify that materials earmarked for foreign markets are actually shipped to those locations.

C. Using informants

Inside information is perhaps the most reliable source of data. Persons within the industry (drivers, warehousemen, etc.) are often cooperative as informants. In lieu of these aides, investigators can place infiltrators or undercover operatives within suspected warehouses to observe activity first hand.

Informants can be developed as part of a negotiated settlement that could have resulted in their prosecution. The investigator is instrumental

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in identifying these individuals and soliciting their cooperation.

D. Investigating through the sales force

Diversion cannot happen without the cooperation of someone within the corporation's own sales force, either by conscious collusion or inattention to obviously suspicious circumstances. When a company (such as PC Dental) places an order which is highly unusual, exceeds the normally placed order by hundreds or thousands of dollars and commits itself to spending money it could not possibly afford to invest, then there is something amiss. The investigator can pull a D&B on the firm, check its assets and determine its normal functioning ability. These are indicators of a possible diversion scheme in the works. If this is done prior to completing the sale, the potential for fraud is reduced or eliminated.

19.8 Countermeasures

A. Positive action

Strong company policy, ironclad contractual agreements and stiff penalties for dealing with diverters are all preventive steps for insuring that problems are reduced. Written policy regarding dealing with diverters should be issued. Prohibitions against changing established price categories for purchasers should be enforced, unless justification can be offered. Contracts which prohibit purchasers from ever dealing with the company again and financial penalties for misuse of the product will hinder the potential diverter. Removing the commission from the salesperson who authorizes the sale to a diverter should quickly put an end to collusion.

B. Regular checkups

Just like going to the doctor, large purchasers of merchandise should receive regular checkups. A periodic review of records, shipping documents, bills of lading and the like can and should be performed. The investigator is perhaps the best person to act as the auditor in such a circumstance. Armed with knowledge of the potential for fraud, he can determine if purchase

orders, bills of lading, transportation invoices and accounts receivable checks are indicative of dealing with diverters.

19.9 Examples

There is a reality to be recognized and understood. The profits gained by product diversion are astronomical. The possibilities are only limited by the imagination of the diverter. In order to combat the problem, the penalties must be great. The investigation must be conclusive and undeniable. The evidence is in the paper trail, and it must be uncovered by methodical attention to detail. Inconsistencies must be uncovered, discrepancies noted, unusual activity recognized and the possibility for fraud thoroughly investigated.

There has been a resurgence of interest in product diversion by manufacturers and legitimate distributors because of the growing number of diverters. The United States Department of Justice, U.S. Attorney's Office, has been bearing down on the diverters. Charges ranging from wire fraud to defrauding the United States Customs Service have been levied against a wide variety of persons involved in the trade of diversion.

The following are excerpts from a classic case, which might prove useful to investigators pursuing this line of endeavor. This is, at the very least, interesting reading for any investigator whose trade revolves around the uncovering of criminal activity. Conspiracy, wire fraud, mail fraud, false statements on a matter within the jurisdiction of a federal agency, the interstate transportation of goods taken by fraud, and the issuing of false bills of lading constitute a large number of the charges you will read about in the following citations.

News Release

U.S. Department of Justice
Office of Robert J. Cleary
First Assistant U.S. Attorney
Newark, New Jersey

A 42-year-old food broker from Saddle River was given a four-month federal prison sentence . . . for his role in false export diversion schemes that cost

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nearly 40 American pharmaceuticals, health and beauty aids, and food products manufacturers as much as \$20 million.

Steven LaSala of Saddle River, NJ was ordered to pay \$1.9 million in fines, forfeitures, and restitution from a Swiss bank account. Additionally, he received a four-month home detention as a result of pleading guilty to wire fraud, customs fraud, and causing a pharmaceutical company to maintain false records of drug distributions.

U.S. manufacturers of branded consumer products often export their products to foreign customers for sale overseas, and commonly grant the export customer a discount of up to 50 percent below U.S. prices. Manufacturers are willing to grant such steep discounts in order to open new markets and expand worldwide sales. . . .

There is a large difference between the wholesale prices charged to domestic consumers and the cost to the export wholesaler. Steven LaSala participated in at least 39 schemes by purchasing products, which he alleged would be sold overseas. However, LaSala did not have any export customers. Instead he resold the product right here in the United States. His profits from these schemes were enormous because his purchase price was significantly lower than the price offered to other domestic distributors.

LaSala's devious diversion schemes included shipping goods overseas to an intermediate port (such as Belgium or Holland) but immediately returning the goods to the United States as "American Goods Returned." This title allowed the goods to enter duty-free. He accomplished his scheme by false invoicing and fraudulent documents giving the impression that the goods were destined for overseas sales, but were not successfully sold in that market. Therefore, Customs officials saw the returning goods as "returns." In fact, they were heading directly to the originally intended destination on the shelves of American retail stores.

LaSala's scheme, in which goods were never shipped overseas, caused direct harm to the U.S. Government . . . because defrauded food

manufacturers often used shipping documents (which in this case they did not know were false) to obtain monetary and subsidy benefits from U.S. Customs and Department of Agriculture programs designed to promote exports of U.S. finished goods.

For example, the First Brands Corporation, in Stamford, Conn., used false bills of lading obtained from LaSala's group to obtain rebates, called 'drawback,' from the U.S. Customs service, of duty that was paid on imported raw materials used to make exported finished goods.

First Brands manufactures 'Glad Bag' brand plastic bags, importing petroleum-based resins to manufacture the bags and paying an import duty to Customs when it brings those resins into the U.S. Under the 'drawback' program, First Brands submitted the false bills of lading in order to obtain a refund of the duties that it had previously paid to import the resins. Since the goods were never exported, First Brands was not entitled to the drawback. . . .

Additional charges against LaSala included the "causing (of) Bock Pharmacals Company of St. Louis, MO, to maintain false records of drug distributions by falsely representing that goods bought by LaSala would be sold in Nigeria." These drugs never reached Africa, but found their way to shelves in the United States. Thus the FDA regulations on accurate recording keeping for drug distributors was rendered inadequate. It allowed for defective, adulterated and tampered product to enter the marketplace and caused the possibility of a public health problem.

Of the 39 admitted false representations, the following companies were subject to LaSala's fraud: First Brands; Nestle; Duracell; Eveready; Cadbury/Mott's; American Cyanamid/Lederle; Tedmond; General Mills; Ralston Purina; Alpo Pet Foods; VanCamp/Hormel; White Laboratories; American Dermal; Bock Pharmacal; Forest Pharmaceuticals; Cetylite Industries; Research Industries; ICN Pharmaceuticals; Fissons Pharmaceuticals; Schwarz Pharmacal; Polythress Labs; Baker Cummings; Elder Pharmaceuticals; CIBA Pharmaceuticals; Ferndale Laboratories; CB Fleet; Fleming & Company; Fujisawa

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Pharmaceuticals; CCA Industries; DeWitt Corp.; John O. Butler Col; BIC; Golden Grains Company (Rice-A-Roni); Quaker; R.T. French; Tsumora Medical; Pro-Line; Hunt/Wesson and Proctor and Gamble.

This scheme, involving Steven LaSala and John Trimarchi in the United States and Adamu Ahmed Abdulkadir in Nigeria, came to a conclusion in January of 1995. From approximately 1987 until 1992, these men and others wove their uncanny and complex web of deception. Posing as exporters, but hardly ever removing product from this country, they purchased everything from chocolate to over the counter drugs at the enticingly low prices offered to overseas purchasers. They artfully placed these products in the hands of retailers, most of whom had no idea that they were purchasing wrongfully obtained merchandise. Their profits were phenomenal. They literally tripled, and in some cases quadrupled, the profit margin of the normal wholesale purchaser, wrecking havoc with the U.S. Customs Service, special government purchasing programs and pharmaceutical accountability standards.

Abdulkadir was the owner/operator of "Elstow Nigeria, Ltd" which co-conspired with LaSala and his U.S.-based company "Kally United." Health and beauty aids were shipped to his country and immediately turned back to the United States. All three men were charged and sentenced in this matter.

News Release

U.S Department of Justice
Newark, New Jersey

On August 7, 1995 another scheme was uncovered and a 55-year-old American doctor of pharmacology was arraigned on charges that she and two others conspired "to commit 'false export' diversion schemes that cost four American manufacturers of consumer goods, medical devices and prescription drugs millions of dollars in losses.

Mary Ellen Kitler . . . of Norristown, PA . . . was charged in an indictment returned by a federal grand jury on July 25th with conspiracy, wire

fraud, mail fraud, false statements on a matter within the jurisdiction of a federal agency, the interstate transportation of goods taken by fraud, and issuing false bills of lading. Named as victims in the Indictment are Johnson & Johnson of New Brunswick, New Jersey; Bayer Corporation's Miles Diagnostics Division ("Bayer") of Tarrytown, New York; ICN Pharmaceuticals, Inc. ("ICN") of Costa Mesa, California; and Nestle U.S.A. ("Nestle") of Glendale, California.

These two examples represent only the tip of the iceberg. There are thousands of diversion schemes ongoing regularly across the United States. This author has investigated cases that have crossed the country in pursuit of misdirected merchandise. Diversion schemes have been investigated in Colombia, Gambia, Belgium, Mexico, Canada, Thailand and Japan.

19.10 Prevention

Diversion is a totally preventable abuse of product distribution. A well-versed product diversion investigator accompanied by a motivated management team could bring diversion activity to a standstill. Strong corporate policy accompanied by strict controls and harsh contractual penalties would be the first step.

Prophylactic measures can be conducted to avoid the possibility of diversion. Tracking can be done of all large wholesale cash purchases. This is especially important where wholesalers are requesting tier discount pricing for such specialties as closeouts, charity or international sales.

Product coding (lot numbers, including dating, intended distributor, factory designation and special packaging) should all be employed as part of the manufacturing process. Contracts should be backed by performance bonds to ensure that distributors maintain the intended lines of distribution. Product and price integrity could be maintained if the proper programs and contracts were put in place. Enforcement of controls and policy must be maintained in order to provide notice to diverters that distribution abuse will not be tolerated. These measures, and their

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maintenance, are only cost effective for Class A companies.

While the East Coast seems to be the home of an abundance of diverters, diversion can and does occur almost everywhere. The investigative work is exacting and the hours of thrashing through documents seem endless. However, there is nothing quite like the satisfaction which comes from successfully putting the pieces together.

Aggressive corporate policy and security departments that have committed the proper resources, own use agreements, strong distribution contracts and experienced diversion investigators have recovered millions and millions of dollars of lost profits for many companies. This specialized investigative arena is the home of some of the country's most capable investigators.

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NEWS, United States Department of Justice U.S. Attorney, District of New Jersey (Robert J. Cleary, First Assistant U.S. Attorney) Distributed on Wednesday, July 26, 1995.

Police Humor

So you thought police officers didn't have a sense of humor.... The following were taken from actual police car videos around the country.

#15 "Relax, the handcuffs are tight because they're new. They'll stretch out after you wear them awhile."

#14 "Take your hands off the car, and I'll make your birth certificate a worthless document."

#13 "If you run, you'll only go to jail tired."

#12 "Can you run faster than 1,200 feet per second? In case you didn't know, that is the average speed of a 9mm bullet fired from my gun."

#11 "So you don't know how fast you were going. I guess that means I can write anything I want on the ticket, huh?"

#10 "Yes, Sir, you can talk to the shift supervisor, but I don't think it will help. Oh.. did I mention that I am the shift supervisor?"

#9 "Warning! You want a warning? O.K., I'm warning you not to do that again or I'll give you another ticket."

#8 "The answer to this last question will determine whether you are drunk or not. Was Mickey Mouse a cat or a dog?"

#7 "Fair? You want me to be fair? Listen, fair is a place where you go to ride on rides, eat cotton candy, and step in monkey \$#*!."

#6 "Yeah, we have a quota. Two more tickets and my wife gets a toaster oven."

#5 "In God we trust, all others we run through NCIC."

#4 "Just how big were those two beers?"

#3 "No sir, we don't have quotas anymore. We used to have quotas but now we're allowed to write as many tickets as we want."

#2 "I'm glad to hear the Chief of Police is a good personal friend of yours. At least you know someone who can post your bail."

Developing the Informant

John Belrose
Director of Operations
AM-CO International Investigations
Holden, Massachusetts

Having been advised about a box of 150 expensive fragrance labels being found during a police raid on a brothel, AM-CO International Investigations, began to explore the possibility of attempting to develop informants within the so called "combat zones" of large Massachusetts cities. The target—prostitutes. Of interest to investigators would be

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the sale and/or diversion of intellectual property. Of particular interest: clothing, handbags and fragrances. However, investigators should listen to any counterfeit and/or diversion story.

A city with about two miles of a main street known for prostitution and other illegal activity was selected. A recon of this street revealed just what investigators were looking for.

Prior to conducting an operation in any questionable area of the city, investigators should check in with local police. It is one thing to check in with police dispatch and provide a detective license and vehicle information. In most cases it is the vice squad that will be controlling operations in combat zone areas. In order to avoid conflict, it is suggested that vice squad officers be advised of your intent.

Prior to setting-up in a combat zone, the investigator should be well aware of the mentality and character of the potential informant. A very large percentage of prostitutes are drug addicts, convicted felons, and, above all, liars. They all have a story to tell as to why they are on the street.

At first, investigators must make a decision not to waste time talking to obvious addicts, ladies with pimps, ladies residing in city operated shelters, or the very young. However, using those four parameters to select an informant would take forever. Investigators should not waste time trying to explain terms such as intellectual property and/or diversion. The term used should be counterfeit: counterfeit as in clothing, handbags and fragrances. However, investigators will listen to any story regarding counterfeit products. Due to credibility problems, do not expect your informant to be of any help in a court room. This type of informant is used to further an investigation and that is it.

The Approach: The investigator will immediately be asked two questions by the hooker—Do you want to go out? And are you a cop? The investigator should answer no to both questions. Keep it simple, and advise the lady that you are a Private Investigator in search of counterfeit products. You have money to spend for reliable information. The

magic word is “money”. If she is willing to talk business, take her out of the combat zone. Explain to the lady the kind of counterfeit that you are searching for. Keep in mind the mentality and condition of the person with whom you’re talking. Keep the conversation simple. Furthermore, avoid asking personal questions because doing so tends to scare them. In most cases you would not get a truthful answer anyway.

There are numerous counterfeit products out there. Do not confuse your informant with everything from A to Z. If your investigation concerns fragrance, open the conversation with that. Let it be known that you are also interested in clothing and handbags or any counterfeit that the informant may have knowledge of.

The Money: The only money that your prospective informant receives is for reliable and verifiable information. Money in advance is out of the question. The investigator needs to be very clear on advance money. Payment will depend upon quality of information received. It will be difficult for the investigator to arrive at a money figure until the informant’s information is verified. This should be made very clear to the informant from the beginning. If the investigator gets lucky and the informant reveals names, locations and method of operation, advise her that she will make a lot more than the \$40.00 she gets to turn a trick. The only promise should be that of money and not any type of intervention with authorities or courts regarding legal matters.

Communication: If an investigator is able to develop a reliable informant there will be a need to communicate. Most ladies of the evening have cell phones as do investigators. If the investigator believes that he or she has a reliable informant, exchanging cell numbers should not be a problem. Avoid meeting informants in combat zone areas. No office meetings and no home meetings. A trained investigator should have no problem establishing lines of communication. Communicate to the informant that merely having knowledge of a counterfeit product may not be cause for legal problems.

During the summer of 2005, AM-CO International Investigations was asked to conduct inquiries

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regarding a specific brand of fragrance. The fragrance in question was endorsed by a well known celebrity. Counterfeit fragrance had been found. An investigator was assigned to go into the combat zone of a large city in western Massachusetts, and develop an informant.

While in the parking lot of a well known coffee and donut establishment, the investigator was approached immediately. The investigator had no interest in the first three approaches. The fourth approach exited from the passenger side of a motor vehicle operated by a second female. The fourth approach, now known as Sue, entered the investigators vehicle. The investigator immediately advised Sue that he was not looking for a good time. The investigator identified himself to Sue and advised that he was looking for information and had money to pay for the information, if and only if, the information was reliable. Of interest was counterfeit and or diverted fragrance. Sue advised that counterfeit "stuff" was being sold around City Hall. Sue went on to say that she knew of counterfeit handbags and clothing being sold by Asians and other nationalities. Sue claimed that she had not observed any counterfeit fragrances.

The investigator spent approximately two hours with Sue. Sue asked for and was assured that her identity would be kept confidential. Investigator and Sue exchanged cell phone numbers. Sue was informed that if counterfeit products are being sold around City Hall, investigators would need to know who was selling the counterfeit, how it was getting into the city, and a description of products.

The information provided by Sue regarding counterfeit being sold around City Hall was verified. A very small quantity of hand-bags and wallets was being sold.

Approximately two weeks after the initial contact with Sue, she contacted investigators and advised that she had some information regarding counterfeit products. A meeting was arranged. Sue had not yet asked how much or when she would be paid. This may have been a result of the initial meeting when she was advised not to pressure investigators for money.

Investigators met with Sue at a location away from the combat zone. Sue asked that she in no way be connected to the information that she was about to reveal. Investigators assured Sue that there would be no reason to involve her in any investigation regarding her information. Sue was again advised that because of her present occupation as a prostitute she was being used as an information source only.

Sue found out that counterfeit products were being distributed from a City located in northwestern Massachusetts. The counterfeit was made up mostly of name brand handbags. Sue provided investigators with the names of two individuals involved: One male and one female. The female made a statement that she could get any type of counterfeit. Most of the counterfeit was coming into Massachusetts from New York. Sue provided investigators with the name of a company involved in bringing the counterfeit into Massachusetts. Sue was compensated accordingly for the information provided.

The information provided by Sue was verified by authorities and later by police raids. The names of several suspects and companies were uncovered. AM-CO International Investigations has this information on file.

A working relationship continues with Sue, although because of her occupation and various other issues she is becoming more difficult to contact.

Investigators need to keep in mind that recruiting and managing street people as informants is a never ending headache. A well trained investigator with common sense and street smarts should have no problem. Keep in mind that one of the biggest problems is will your informant throw in with the bad guy?

"A good ole boy is somebody that rides around in a pickup truck and drinks beer and puts 'em in a litter bag. A redneck rides around in a pickup truck and drinks beer and throws 'em out the window."

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