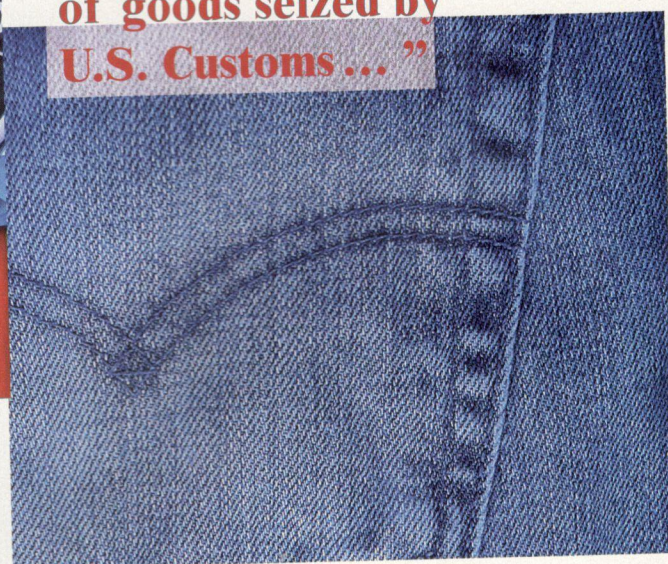


Pursuing the Counterfeiters

By Paul Paradise

“...the dollar amount of counterfeit goods seized by IACC private investigators surpassed the dollar amount of goods seized by U.S. Customs ...”



Trademark counterfeiting is one of several business crimes involving consumer products. The others are product tampering, gray market goods, and product diversion. These business crimes were rarely seen until the last half of the last century. The development of a global economy has played a major role in the upsurge. The global economy, in turn, is the result of technological advances in packaging, merchandising, and communications.

Trademark counterfeiting

Trademark counterfeiting? Most people have never heard of the term, although they may be familiar with names like knockoff, pirate, replica, and bogus. The products being counterfeited are limited only by the human imagination. A partial list includes designer jeans and watches, computer software, music CDs and DVDs, and auto and airplane parts.

Trademark counterfeiting is a business crime so huge that counterfeit apparel and music CDs are openly sold on the streets of most major cities around the world. For the most part, consumer and law enforcement ignore this underground business, which many people think of as a victimless crime. Since the counterfeit goods are produced outside of the legitimate manufacturer's operation, it is surmised that no one is hurt. Hence, the crime often goes unnoticed and unpunished. The International Chamber of Commerce, based in England, estimates that five to seven percent of all world trade involves counterfeits.¹

Trademark counterfeiting dates to Biblical times. Cattle rustling, otherwise referred to as “stealing the brand,” was an early form of trademark counterfeiting. Under English common law, trademark counterfeiting was called “palming off.” What the counterfeiter does is to use a ruse “palm off” the merchandise as being legitimate. The ruse usually involves attaching a replica of the brand name or trademark to the product. Legal actions often refer to trademark counterfeiting as “palming off.” Included in the cause of action are packaging (referred to as the trade dress), as well as illegal use of the federally registered trademark.

The most effective legal remedy under civil law for dealing with the counterfeiters is the 1984 Trademark Counterfeiting Act [18 U.S.C. 2320], signed into law by President Ronald Reagan, and amended in 1996. An ex-parte seizure is a seizure conducted without prior notice to the counterfeiter, upon a proper showing of evidence. The 1984 Act opened up a new field of investigation for professional investigators who specialize in intellectual property including copyrights, trademarks, and patents.

The International Anti-Counterfeiting Coalition (IACC), a trade group based in Washington, D.C., which drafted the

bill that was signed into law as the 1984 Trademark Counterfeiting Act, has a private investigator's task force. Initially headed by private investigator Robert Holmes, founder and president of Holmes Hi-Tech, based in New York and New Jersey, the committee's first project was to compile a statistical report of the goods seized by IACC investigators. The report, the first of its kind, showed that the dollar amount of counterfeit goods seized by IACC private investigators surpassed the dollar amount of goods seized by U.S. Customs for that year.² Their 2002 report showed that seventeen IACC investigative firms seized nearly eight million counterfeit items and chalked up four thousand, five hundred felony charges.³

Obtaining an assignment

Most assignments involving counterfeit goods come from the business or corporation that is victimized. The business, in turn, gets its leads from customer complaints about the product ("the color washed out" or "the fabric rips easily"), or from the sales force or manufacturer's representatives who discover a whole-

representing the company or through in-house counsel.

Leads sometimes come from investigators who are working "on spec." These investigators make buys of counterfeit goods by canvassing flea markets and other second-hand stores or by making buys from street peddlers. After making a buy, the investigator ascertains that the merchandise is counterfeit and sends it to the company in hopes of securing an assignment.

Working "on spec" is a gray area in

"Since trademark counterfeiting is a federal offense, the investigator will usually be working in conjunction with the U.S. Marshals Service."



salor or distributor selling company products at an unusually low price. Additional leads come from business documents picked up during a seizure of counterfeit goods that identify other businesses in the counterfeiting chain.

Each of these leads can become an investigation. Investigators receive their assignments either through a law firm

the private investigation field. This is different from investigators who receive an assignment, and in addition to the hourly rate, are paid a bounty for each counterfeit item that they find. This is not working "on spec," since the investigator is working on assignment and being paid. Soliciting business by working "on spec" is illegal in many states and viewed as

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ambulance chasing. The wise investigator will check state laws before engaging in this activity.

Investigating counterfeit products

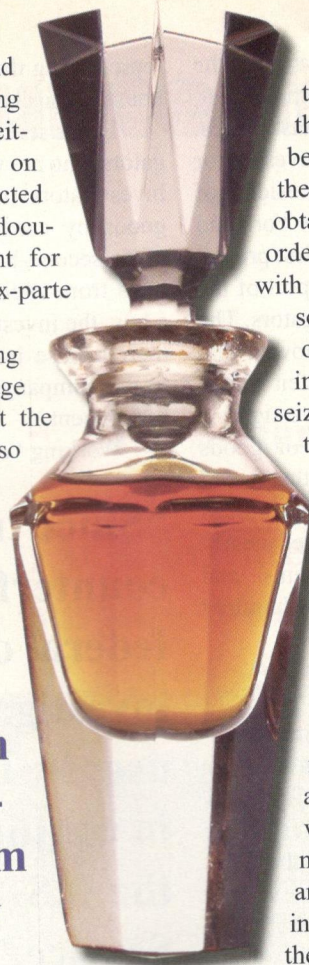
Most investigations involve obtaining a sample of the merchandise. Many manufacturers have a product identification kit that will describe the distinguishing design and security features of the genuine product, as well as flaws observed in the counterfeit products. These kits are given to the sales force, legal department, and investigator.

The investigator obtains a sample of the suspected counterfeited product, and sends it to the client for verification. If counterfeit, the company's product manager will sign an affidavit attesting to the product's defects. The investiga-

tor will then prepare and sign an affidavit attesting to substantial counterfeiting activity taking place on the premises of the suspected counterfeiter. These two documents are a requirement for an application of an ex-parte seizure order.

Prior to authorizing an ex-parte seizure, a judge will usually require that the plaintiff post a bond, so that the defendant will have a legal recourse should the seizure prove groundless. The ex-parte seizure order is kept under seal, so as to not to alert the suspect.

"... the investigator knows the scam from the beginning of the investigation because the lead originates from the client, who also determines how the investigation will proceed."



Since trademark counterfeiting is a federal offense, the investigator will usually be working in conjunction with the U.S. Marshals Service. After obtaining the ex-parte seizure order, the investigator will meet with the deputy U.S. Marshals to schedule the seizure. The job of the U.S. Marshals is to assist in the service of process (the seizure order) and to ensure that the seizure is conducted peacefully. If the suspect becomes violent, the Marshals will make an arrest.

The investigator's job is to lead the seizure team. The language in the seizure order should include not only the counterfeit goods, but anything used in the production, manufacture, distribution and advertising. Hence, the seizure will also confiscate the business records, machinery, and anything else that might be used in the manufacturing process. If the seizure is large, trucks and storage facilities will have to be

rented.

The ex-parte seizure is an expensive legal venture. The plaintiff must pay for the investigator's services, posting of bond, storage of the defendant's counterfeit merchandise, and legal expenses. Most defendants never show up in court and the plaintiff wins a default judgment. The judgment is probably worth little, since in most instances the defendants are indigent, with few assets to forfeit.

Pursuing the street peddlers

Street and flea market peddlers are the most numerous and difficult counterfeiters to pursue. They are mobile and not likely to stay in one location for any length of time. Their inventory of counterfeit goods is small and deals are for cash.

The ex-parte seizure remedy is usually too expensive to use when dealing with these petty criminals. The most effective legal tool is a "Roving John Doe" seizure order. The order empowers a private investigator and authorizes confiscation of counterfeit goods upon an examination. Following purchase and inspection of the suspected counterfeit

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goods, the investigator should show personal identification and a copy of the seizure order before confiscating the product. Most street peddlers are savvy, and will surrender the goods without a fuss and "write off" the loss as a cost of doing business. They will be back on the street the next day.

Diversion and gray market goods

Diversion involves the unauthorized sale and distribution of legitimate merchandise outside of the normal distribution channels. Diversion is a potential problem for every company that has a large manufacturing and distribution chain.

Diversion is not theft, which is an unauthorized taking. Diversion is the unauthorized distribution achieved by misrepresentation. Since diversion is essentially a contract or licensing dispute, the legal remedies are limited.

Diversion often involves goods manufactured in one country for export to another country. For example, a brand name men's shirt that sells for sixty dollars in an upscale retail store may cost one dollar to manufacture abroad. Many apparel manufacturers in the United States produce their goods in Asia because China is the leading cotton producer in the world and because labor is cheaper in Asia. Although the manufacturer licenses its product through

purchasing one hundred units, a thirty-percent discount for purchasing five hundred units, and a forty-percent discount for purchasing one thousand units. Thus, a large wholesaler with a stock of goods purchased at the forty-percent discount rate is in a position to make deals that undercut the manufacturer.

Not all discount rates are based on quantity. Sometimes discounted products are the result of marketing and pricing strategies used by U.S. businesses to promote their products abroad, or through tax incentives and export subsidies that encourage U.S. manufacturers to sell their products abroad at a discount price.

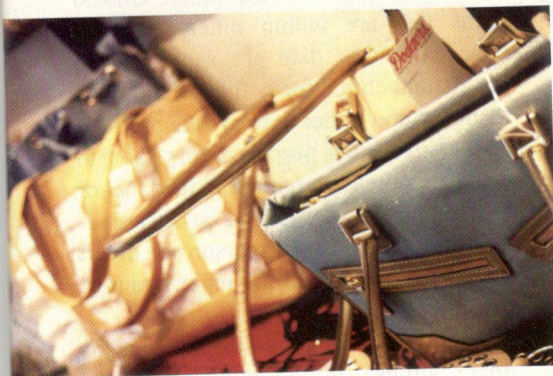
The result of these pricing or tax incentive programs is a disparity in the price charged domestically and in other countries. For example, each day thousands of Americans, many of them senior citizens, travel to Mexico to purchase pharmaceuticals at discount prices. The business is so lucrative that many border towns now advertise on U.S. television and radio stations. Many drugs requiring a prescription in the United States are available over the counter in

Mexico. Discounted drugs purchased in Mexico are legitimately purchased, and result from pricing strategies used by the U.S. pharmaceutical industry, which spends millions of dollars to develop a drug, then sells the drug domestically at a higher price than in Mexico and other countries to recoup their investment.

Diversion of goods in an import/export scheme is called *gray market goods* or *parallel imports*. The goods are legitimate, bear an authentic trademark, and in most cases pass through customs. Gray market goods are a huge problem in the United States and in Europe.

"Gray market/parallel import products bear the trademark with the trademark owner's consent," says Tim Trainer, president of the IACC. "In that sense, they are not counterfeits, because of the marks being applied legally."⁴

In 1989, the U.S. Supreme Court upheld the right of U.S. retailers to purchase legitimately produced goods (cameras, perfumes) from foreign distributors.⁵ U.S. manufacturers have tried several strategies. One strategy involved copyrighting the packaging on the goods. Under copyright law, the



selected wholesalers and retailers, there are ample opportunities for an unscrupulous middleman with contacts to make a profit by selling outside the distribution chain.

The pricing and discount policies used by most major companies are a major reason for diversion. Discount rates are based on quantity. For example, a wholesaler may receive a twenty-percent discount from the manufacturer for

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copyright holder has the exclusive right to distribute copies of his or her work. The Coalition to Protect the Integrity of American Trademarks (COPIAT), a trade group that represents many perfume and watch manufacturers, pioneered the use of this legal strategy in the case *Parfums Givency, Inc. v. Drug Emporium, Inc.* 38 F.3d 477 (9th Cir. 1994). The use of this strategy was struck down in 1998 by the U.S. Supreme Court. According to Trainer, an effective method of combating gray market goods is to include provisions in the licensing agreements offered to licensees and distributors, imposing sanctions and other penalties for unauthorized distribution. "Trademark owners need to ensure that all legal agreements between them and their manufacturers, distributors, suppliers, licensees, etc. have provisions that permit certain 'sanctions' or 'penalties' or other remedial acts when someone in the chain allows the goods to be placed outside the authorized chain," he says.

"Diversion results from a flaw in the distribution chain and can be eliminated," according to Reginald Montgomery, an investigator based in New Jersey, who also wrote a chapter on diversion in *Corporate Investigations*.⁶

Montgomery, who has over thirty years experience investigating trademark counterfeiting and diversion, has investigated numerous cases involving charity diversion, returned merchandise, promotional diversion, and dated products.

According to Montgomery, the investigator knows the scam from the beginning of the investigation because the lead originates from the client, who also determines how the investigation will proceed. The client may authorize the investigator to conduct a due diligence background check of the suspect to identify any convictions or judgments. The client may also authorize surveillance of the suspect to identify other business contacts. Many investigations involve making a buy of the product.

Diversion as an unauthorized distribution often involves charitable donations of returned merchandise and products that have exceeded the expiration date. When an item of apparel, such as a shirt, returned to a store, the manu-

facturer will donate the shirt and take a tax write-off for the cost of the shirt. This is more profitable than re-packaging the shirt. However, charitable donations involve legitimate products that can be diverted back into the stream of commerce by an unscrupulous organization or middleman.

Product tampering

Diversion often involves comestibles that have exceeded or are close to exceeding their shelf life. The products are diverted by removing the label or by re-labeling the product.

Diversion that involves re-labeling, or removing the label, of a product may be classified as product tampering, which involves the unauthorized access and alteration of the product.

Product tampering first made national headlines with the tampering of tylenol® in the early 1980s. Several people died. Product tampering is a crime under many state and federal statutes, including the Anti-tampering Act (18 USC 1365), signed into law as part of the Comprehensive Crime Control Act of 1983. A person who tampers with a product that subsequently results in the death of another person can receive a life sentence, as well as a substantial fine, under the Anti-tampering Act.

Food stocks and over-the-counter medications have an expiration date that is indicated on the label. Unsold items that are within ninety days of their expiration date are sent back to the manufacturer for a full refund. The manufacturer either destroys the product, donates it for tax purposes, or sells it to discount stores. By removing the label or re-labeling these products, an unscrupulous middleman or salesperson can divert the product back into the mainstream of commerce.

Products may be re-labeled for legitimate purpose. In one study, conducted by a professor of pharmaceutical economics at the University of Minnesota, re-labeling of pharmaceutical drugs has been steadily growing from 791 in 1990 to 20,801 in 2002.⁷

Conclusion

A new field opened up for private investigation in the wake of the enormous growth in crimes involving con-

(continued on page 70)

using outside entities to assist by preparing reports based on interviews in investigations of alleged workplace misconduct. Concerns arose because such investigations might be hampered by FCRA obligations, such as the requirement that an employer obtain the authorization of an employee before obtaining a consumer report and the requirement that the employee be provided a copy of the report before the employer can take adverse action. Several Congressional proposals to amend the FCRA to meet the workplace investigation concerns have been introduced.

In 2000, the Commission commented (see <http://www.ftc.gov/os/2000/03/ltrpitolofskysessions.htm>) and testified with respect to one such proposal (see <http://www.ftc.gov/os/2000/05/fcratestimony.htm>).

Beales stated, "The Commission remains of the opinion that a legislative remedy of the type endorsed by the Commission in 2000 is the most appropriate response to these concerns."

Congressman Pete Sessions was responsible for introducing the legislation referenced in 2000, and he should

be commended for once again sponsoring and re-introducing H.R. 1543.

It is important that all professional investigators continue to write and visit our congressional representatives and ask for them to co-sponsor H.R. 1543. Our cause is gaining much needed support,

but there is much more that needs to be done. We will keep you updated as news develops.

Keep writing, calling, faxing, and e-mailing your representatives.

PI

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sumer products. However, the need for quality investigators, particularly in Asia and Latin America, remains acute. Investigators choosing to add this specialty to their business should strive to be fully informed on federal, state and international regulations.

Endnotes

- ¹ International Trade Commission Study. Referenced in April 17, 2003 E-mail interview of Tim Trainer.
- ² Interview of Bob Holmes, Holmes Hi-Tech.
- ³ "IACC 2002 Counterfeit Stats Indicate Growing U.S. Problem," *Authentication News*, March 2003, Vol. 9 No. 3, p. 12.
- ⁴ Tim Trainer, April 17, 2003 E-mail interview.

⁵ See article: Stuart Taylor, Jr. "Discount Stores Win 5-4 Ruling in Supreme Court," *New York Times*, June 1, 1989, pp. A1, D6.

⁶ Montgomery, Reginald J. and Majeski, William, *Corporate Investigations*. Lawyers and Judges Publishing Company, Inc., Tucson, AZ 2002.

⁷ See article: Melody Peterson, "Bayer Agrees to Pay U.S. \$257 million in Drug Fraud," *New York Times*, April 17, 2003. pp. C1, C6.

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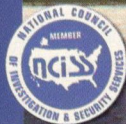
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