

**TESTIMONY**  
**OF**  
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**16 July 2003**  
**BEFORE THE**  
**HOUSE COMMITTEE ON INTERNATIONAL RELATIONS**  
**HEARING ON**  
**"Intellectual Property Crimes: Are Proceeds From Counterfeited Goods**  
**Funding Terrorism "**

Mr. Chairman and members of the committee I want to thank you for the invitation to testify at this very important hearing.

For the record my name is Larry Johnson. I am a founder and partner in BERG Associates, an international consulting firm that specializes in investigating product counterfeiting, money laundering and counter terrorism. We provide case support to DEA and US Customs, military exercise support to the Department of Defense, and compliance and due diligence support to financial institutions and brokerages. Before starting BERG Associates I served with the Central Intelligence Agency (1985-1989) and the US State Department's Office of Counter Terrorism (1989-1993).

I commend this committee for shining the light of publicity on the relationship between terrorism and product counterfeiting. I do not know if the proceeds from counterfeited goods have funded terrorism but I do have firsthand knowledge that individuals and families with direct ties to terrorist groups have been involved with product counterfeiting and have profited from selling counterfeit goods.

Most people know what terrorism is, but few understand the scope and scale of product counterfeiting. Moreover, why would a terrorist want to sell a counterfeit toaster or pack of cigarettes? The answer is simple and direct-- money. All terrorist groups—Marxists as well as the Islamic extremists—need money to plan, organize and conduct terrorist attacks.

Money may not be the root of all evil but it is a critical resource for any group that wants to carry out international terrorist attacks. Building a car bomb or hijacking a plane does not require a vast fortune; these things can be done relatively cheaply. But these activities still depend on funding. Aspiring terrorists must be taught how to build bombs. They need a physical place to train, qualified instructors, access to the materials required to assemble a device, and the time to devote to this activity without having to worry where the next meal is coming from.

Beyond the costs of recruitment and training, international terrorists also face the bugaboo of logistics and travel expenses. International terrorists do not have their own "Transportation Command". They cannot call on a fleet of military aircraft or ships to move them from point A to point B. When they travel from one country to another, whether for planning or conducting an attack, they must use some form of public transportation (or else they must walk). They travel like most private citizens. They buy airplane tickets, they get on trains, they board ships or they drive cars. This means they have to have cash or a credit card. And once the terrorist arrives at his destination he still has to cope with the mundane tasks of paying for daily living expenses.

Prior to 1991, almost all active terrorist groups relied in some measure on countries (e.g., the Soviet Union, Iran, Iraq, Libya, Syria, Saudi Arabia, Greece, and Cuba) to bankroll their activities. But the collapse of the Soviet empire in 1991 cut off an important source of funds to many terrorist groups, especially communist groups. Moreover, states that had funded and protected terrorist groups began reducing their support in the face of international pressure. Libya, for example, dramatically scaled back its support for terrorist groups following UN sanctions levied against it for its role in the bombing of Pan Am 103. Consequently, terrorist groups turned to a variety of activities, including charitable contributions, narcotics trafficking, cigarette smuggling and, I believe, selling counterfeit products.

#### WHY COUNTERFEITING?:

The violation of intellectual property rights by the distribution or sale of counterfeit goods offers an attractive, profitable method for making good money while avoiding the penalties associated with high risk activities such as smuggling or drug trafficking. The latter are more likely to attract law enforcement attention and can carry hefty legal costs for those caught doing these things. Selling counterfeit products, however, is a relatively risk free activity. Even if caught in the act a merchant probably will suffer nothing worse than the loss of the money he spent to purchase the goods and having the counterfeit products confiscated. A merchant rarely is jailed for selling or distributing counterfeit merchandise.

What is the appeal of counterfeit merchandise? People around the world, regardless of income level, want to buy name brand products and, if offered a discount, will grab it up. Counterfeit products bear the labels of Sony, Ralph Lauren, Calvin Klein, Philip Morris, Black and Decker, Nike, Reebok, and Sunbeam but can be had for a price that is 60% to 70% of the original. The market for products that violate intellectual property rights is huge and encompasses all products, including clothing, stereo equipment, household appliances, televisions, liquor, cigarettes, compact discs, dvds, and shoes.

The IPR violations take three basic forms (these are not mutually exclusive):

- Copyright infringements—A merchant will sell an item that is contained in a package that outwardly is an exact replica of the original. Merchants armed with CD copy machines can churn out illegal copies of hit CDs and package them in a way that the average consumer will not realize is a copy. In several raids in Panama on behalf of Sunbeam Corporation, we have seized products like coffeemakers and rice cookers that were packaged in an exact replica of the Sunbeam/Oster box but contained products that were cheap knock offs. For the unsuspecting consumer, if the package bears the name of a major brand label they expect a certain level of quality.
- Trade Dress infringement—Similar to a copyright infringement except the packaging is not an exact replica. The packaging imitates the look or replicates the colors of the original but alters some details, such as the product name. For example, we helped seize a dvd-based game system that imitated the artwork of a SONY PLAYSTATIONS but the box was labeled "POLYSTATION". One of the first raids my company conducted in the Colon Free Zone of Panama was against Overseas Dispatcher, International, a company owned by Mr. Walid Zayed. Mr. Zayed has direct relations with Palestinian terrorists and claims to be the Latin American representative for the "Intifada". Mr. Zayed, who is also a convicted money launderer, was selling products that outwardly used the same color and artwork as Sunbeam OSTER-brand products but bore the name, "ASTOR".
- Trademark or Patent infringement—Products that are protected with a trademark or patent are reproduced by unauthorized manufacturers and sold by unauthorized distributors. The quality of the replication varies. In some cases it is almost impossible to tell the difference between the counterfeit and the original. In other cases the poor quality of workmanship makes it quite clear which is legitimate and which is illegitimate.

Counterfeit products and packaging create a host of problems. At a minimum, such products create confusion among consumers, who think they are buying a genuine brand, only to discover later that they have an imitation. Consumers eager for a good deal usually do not hesitate to pay a lower price for something they believe may be genuine.

Counterfeiting not only diverts revenue from the company and workers who produce the legitimate items, it also creates a potential tort liability for the companies whose goods are being knocked off. When consumers buy a product that looks like the real thing but is in fact made of inferior material and lacks the safety features found in legitimate products they might have a cause of action against the producer of the legitimate article. More often than not, the counterfeit products are of such an inferior quality that they represent a potential danger to the consumer. In one case we seized coffeemakers that would literally

short out after making one pot of coffee. In another instance a waffle iron started smoking as soon as it was plugged into an outlet for the first time.

#### KEY PLAYERS IN COUNTERFEITING:

Southeast Asia, particularly China, is the major manufacturing center for counterfeit products. Besides China, my company has identified counterfeit manufacturing operations in Thailand, Taiwan, Indonesia, and South Korea. Many U.S. companies who have set up manufacturing plants in China have learned to their chagrin that the Chinese are quite good at copying products, especially those not covered by patents or trademarks. However, in our experience the Chinese have not been willing partners in trying to crackdown on counterfeit operations. In fact our sources tell us that Chinese government and military officials in certain provinces are involved directly in the counterfeiting activity.

Another set of key players in this process are the "Hong Kong Brokers". According to testimony and documents we have collected in the Colon Free Zone, the "Brokers" are Hindu merchants (actually Sindis) based primarily in Hong Kong and Central America who offer to produce any merchandise someone wants to sell. A merchant in Panama who wants to acquire and sell counterfeit products has several options:

- They can visit the office the brokers maintain in the Colon Free Zone and place an order, or
- They are visited by a sales representative for the broker, who has a catalogue that describes potential products, or
- They can travel to Hong Kong (there are biannual fair in March and October of each year) to view merchandise and place orders.

The product brokers specialize in providing "knock-off" items, arrange for the manufacturing, and facilitate the delivery of the finished goods.

The final set of actors are the merchants that work in free trade zones (Figure 1). The free trade zones provide retail and wholesale merchants a chance to buy inventory for their businesses on a tax free bases. The Colon Free Zone of Panama is the second largest trade zone in the world. In addition to Colon, there is the city of Maicao, Colombia, Ciudad del Este, Paraguay, and Iquique, Chile. Most Americans have never heard of these cities. These trade zones provide a massive distribution point for merchants who work inside those zones. In my experience the majority of commercial activity in these areas represents legitimate commerce. However, I also know from personal experience that there is significant movement of counterfeit and contraband merchandise.

Who works in these free zones? The answer depends on the country. In Panama, for example, about 25% of the merchants are of Arab/Islamic descent. Another 30% are Jewish immigrants, 20% Hindu, and the remainder made up of

Chinese and Latinos. Maicao, Colombia and Ciudad del Este, Paraguay, by contrast, are dominated by Arab/Islamic merchants.



Figure 1

#### CENTRAL AND SOUTH AMERICAN FREE TRADE ZONES

Among the Arab/Islamic family groups who work in the Colombian and Paraguayan free zones, there are at least six that are known to the US intelligence community as having direct ties to Hezbollah. At least three of these families have businesses in the Colon Free Zone. My company has conducted undercover investigations against two of these family groups and found them trafficking in merchandise that violated the Intellectual Property Rights of a U.S. publicly traded company.

Many of these family groups also have businesses in Maicao and Ciudad del Este. Ciudad del Este is located in the southern cone of Latin America in a region known as the "Tri-border" area. It is here that the countries of Brazil, Argentina, and Paraguay come together. The Paraguayan city, Ciudad Del Este, is the hub of this region. It is known as a major market for counterfeit and smuggled goods. It also has been the home to a significant Muslim population. One of the residents, at least until recently, is Assad Barakat, a Lebanese-born Paraguayan citizen, who is the enforcer and top fund raiser in the region for Hezbollah, according to Paraguayan and Brazilian authorities. Barakat is alleged to have played a role in terrorist attacks carried out in Argentina in 1992 and 1994.

Outside of our hemisphere Dubai figures as another important Trade Zone for the distribution and sale of counterfeit products. In the course of investigations

carried out by my company we have discovered links between businesses in the Colon Free Zone and the Free Zone in Dubai. Dubai appears to be a major gateway for the movement of counterfeit and contraband goods into Iraq, Afghanistan, and Pakistan.

#### TERRORISM AND COUNTERFEITING:

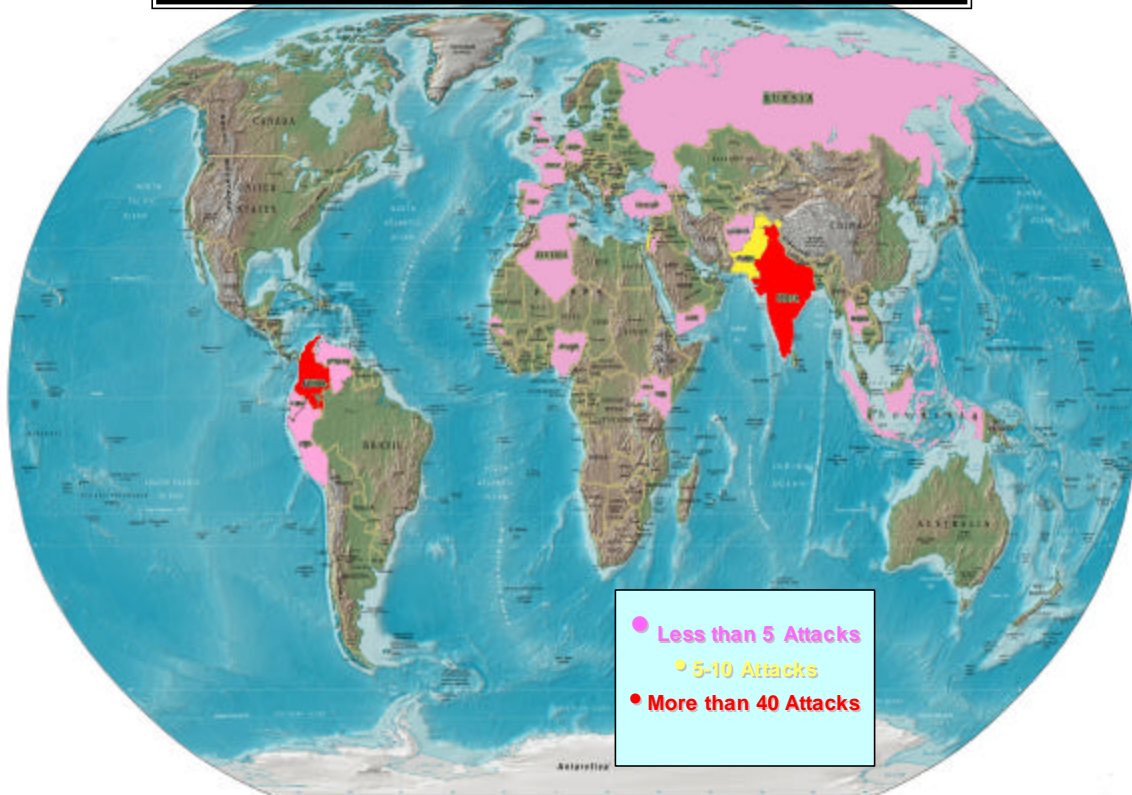
It is important to understand the facts about international terrorism, particularly terrorism in Latin America, in order to appreciate the full implications of the counterfeiting activity. [The following is drawn from the recently published US Department of State, PATTERNS OF GLOBAL TERRORISM 2002.] Last year international terrorist incidents fell to their lowest level in 34 years—199 attacks in 2002. If we examine the details we find that the incidents and fatalities are concentrated in two specific areas of the world, Latin America and South Asia (see Figure 2).

- India and Colombia together accounted for almost 60% of all international terrorist attacks (34% in India and 23% in Colombia). For the first time in five years, a country other than Colombia accounted for most of the terrorist attacks.
- There were 725 deaths worldwide from international terrorism. 80% of these were caused in 68 attacks that occurred in five countries (India, Pakistan, Israel, Russia, and Indonesia). Islamic extremists were implicated in all of these attacks.
- India, with 31, and Israel, with 25, experienced the most attacks that caused deaths.
- Out of 2013 injuries worldwide from international terrorist attacks, 99% of these occurred in seven countries (India, Pakistan, Philippines, Israel, Russia, Indonesia, and Kenya).

Looking back over the last two decades, the vast majority of international terrorist activities in our Hemisphere have been planned and carried out by Marxist-Leninist groups rather than Islamic extremists. The Colombian terrorism has been directed chiefly against the people of Colombia and the foreign companies who are building and maintaining oil pipelines. Although the FARC and the ELN have shied away from attacking foreign targets outside of Colombia, they have conducted vicious bombings and kidnappings inside Colombia. These attacks have left thousands of Colombians grieving and suffering.

Although not very active, Islamic extremists have made their presence felt through isolated terrorist attacks in South America. The 1992 bombing of the Israeli Embassy and the 1994 attack on a Jewish Community Center, both in Buenos Aires, reportedly were staged from the tri-border area in northeast Argentina.

## 2002 International Terrorist Incidents



## WHAT TO DO ABOUT THE PROBLEM?

I can illustrate what we should do about the problem of counterfeiting by recounting an anecdote based on my experiences with aviation security during the 1990-91 Gulf War. In the fall of 1990 the U.S. Government led an international effort to upgrade aviation security standards and practices in order to prevent possible Iraqi retaliation. The ensuing international cooperation was terrific. When hostilities began in January of 1991 the security measures were put in place and there were no terrorist attacks. We did not anticipate, but were pleasantly surprised to learn, that as a result of the security measures there was a dramatic increase in the number of people apprehended carrying stolen airline tickets, money, and drugs. We learned that security measures designed to defeat terrorism would also deter and interdict other criminal behavior.

Although there is no obvious, significant link connecting terrorist attacks to product counterfeiting, the infrastructure for the activity and threat is in place. Let me suggest that strong national and international efforts to crackdown on this activity are likely to serve as a deterrent and preventative measure against future terrorist attacks. In this regard there are some specific things that can and should be done.

First, we are plagued by the classic problem—since there is no apparent immediate threat there is no urgency about concentrating resources to address this threat. At present only the IPR Center at what was once known as US Customs is the only US Government organization focusing on this problem. The Congress and the President can perform an important service by encouraging the various law enforcement and intelligence agencies to pay more attention to this activity.

Second, we need to impose some significant penalties on those who are involved with counterfeiting. Many of the merchants who traffic in counterfeit goods attend merchandise conventions in the United States. One merchant in Venezuela, for example, was convicted and fined for counterfeiting video games. The US Company that owned the intellectual property rights asked the US Embassy to refuse to grant the merchant a visa. The US Embassy refused to grant the request claiming that under current visa laws they had no power to refuse a visa to a prominent merchant.

Third, we need better international cooperation and coordination in addressing the threat of counterfeit goods. China in particular should be a focus of international pressure. As long as China continues to provide factories for manufacturing counterfeit goods the problem will continue. Stop the production and you significantly reduce the problem.

Fourth, we need the companies who are the victims of counterfeiting to work together in a coordinated fashion. I realize that companies need to protect proprietary information. Companies like Sony and Hitachi, for example, have been unwilling to cooperate with each other in going after merchants who are selling counterfeited products, putting more emphasis on keeping corporate information secret rather than stopping the counterfeiters. Better cooperation among the private sector is just as critical as improved cooperation between governments.

Finally, we should not be myopic in the war on terrorism. If we view terrorism as one phenomenon and ignore the other activities, like counterfeiting and drug trafficking, we run the risk of Balkanizing our national security/law enforcement apparatus. The threats of the 21<sup>st</sup> Century require an integrated coherent approach. We ignore the interrelationships at our peril.

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