

WHAT COMPANIES CAN DO TO PROTECT AGAINST DIVERSION

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"Diversion" of U.S. exports may be reaching unprecedented levels due to the increasing use of this scam by organized crime. At its simplest, diversion occurs when a U.S. manufacturer is approached by a foreign buyer (usually a wholesaler/distributor), and asked to ship substantial quantities of goods for sale in a third country. These third countries are generally in regions where the U.S. manufacturer has few existing relationships (such as the Former Soviet Union, Central Africa, etc.). Often, the U.S. company will sell its products at a discount from domestic prices since it can "strip" such overhead as advertising, distribution and warranty costs from the price.

The foreign purchaser then sends cash for the purchase (or opens an irrevocable LC in a well-known foreign bank), and the goods are shipped. End of story? Not quite. In hundreds of instances, the goods never reach their intended destination. Instead, they are stripped from their containers in such ports as Rotterdam and Hong Kong, stuffed in new containers, and rerouted back to the United States. Once here they are entered as "U.S. Goods Returned" (thus paying no duty), and dispatched to buyers such as large discount retail chains. Depending upon the spread between the discount price offered to the foreign buyer and the regular domestic wholesale price, the diverter may net as much as a 30% profit in less than a month.

Even with narrower margins, however, diversion has become a favorite of organized crime, in that it is a near-perfect way to launder offshore cash. When accosted by the authorities, diverter/criminals have a ready explanation for their money: they got it by selling cat food/cosmetics/bicycles/pharmaceuticals in the "diversion" market.

While some types of diversion are at least marginally legal, there is growing evidence that clearly illegal and fraudulent diversion is on the rise. Dozens of lawsuits have been filed in the past two years against diverters, and in some cases the Federal Government has criminally prosecuted phony diversion schemes -- especially those with links to Organized Crime. Imports of "U.S. Goods Returned" are increasing rapidly and account for almost \$1.5 billion/month.

Illegal diversion not only can wreck the marketing plans of U.S. companies which are victims of such scams, but constitutes a gaping loophole in law enforcement efforts to prevent money laundering. Not incidentally, given the size of the illegal diversion, U.S. trade statistics -- especially export statistics, are becoming much less reliable.

Diverterers generally target consumer products which can be disposed of easily once reimported into the United States. These include personal health care products, prepared food (e.g. canned goods), household cleaning products, office supplies, cosmetics, aftermarket auto parts, computer software, etc.

Companies vulnerable to diversion should adopt internal policies to discourage diverterers from making them a target rather than relying exclusively upon legal mechanisms to remedy the problem once it has occurred. Among the things companies can do to protect themselves from becoming victims are:

1. Act as your own shipper -- do not turn goods over to unknown freight forwarders in the United States. Often, diverted goods never leave the country but are purloined before they can even be loaded on a ship.
2. Check unknown buyers thoroughly. There are several law firms and corporate data bases which maintain records on known or suspected diverterers.
3. Copyright all labels, instructions, etc. This provides some legal protection should the goods be re-entered into the U.S.
4. Include a "title retention clause" on all shipping documents indicating that the seller (the U.S. company) retains title to the goods until they reach the country of intended destination.
5. Where feasible, include overt and covert markings on goods so that if they do show up back in the U.S. market, you can trace how they arrived here.
6. Consider your corporate structure. Some companies separate foreign and domestic marketing departments. These are most often victims of diversion. The foreign department wants to maximize export sales at any cost, while the domestic marketers are so afraid of diversion that they resist almost any foreign market opening. Structuring sales by product line rather than by geography (i.e. domestic vs. foreign) can temporize this conflict, since managers want to maximize profit on all sales, wherever they occur.
7. If you discover that your goods have been diverted, Seek outside professional assistance immediately, and keep the information as closely held within the company as possible. It is unfortunate but true that in a substantial number of diversion cases, the diverterers have had advertent or inadvertent assistance from faithless or foolish employees of the victim.

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