

WHAT IS DIVERSION?

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That cheap bag of pet food that you picked up on a "special" at your local discount store was originally destined for Pakistan. The inexpensive, brand-name cleaning compound you bought was supposed to be in the Ukraine by now. How did it wind up in San Jose? Diversion.

Diversion has become a multi-billion dollar industry in the past decade. It mixes equal portions of larceny, chutzpah, greed, and ignorance into a profitable stew for sharp international traders and organized crime. Although the scheme has numerous variations, it often works along the following lines:

A major U.S. consumer products company receives a large order for goods from an offshore trading company. The buyer says it has a buyer in Malawi (or some other remote land) for \$500,000 worth of widgets. The U.S. manufacturer, not maintaining a distribution system in Malawi, agrees to the sale on condition that it be paid in cash and that the buyer certify that the goods are indeed destined for that country. Within days, payment for the goods is made (or an irrevocable letter of credit opened in a major European bank), and the goods are shipped. Three weeks later, however, the products wind up in Nashville, TN. What happened?

Upon further investigation, the U.S. company determines that the original "buyer" was in fact a "company" operating out of a filling station in Panama City, Panama and the Malawian "consignee" was fictitious. The goods were indeed shipped, but on their way to Malawi, were offloaded at an entrepot trade port such as Rotterdam, where they were reloaded into separate containers, and sent back to the United States, where they were imported by a shadowy U.S. "trading house" with links to the Mafia. The products are then sold to legitimate discount stores as "production overruns".

There are numerous variants to the scenario described above. Sometimes, the goods never even leave the U.S. dock, and are diverted to unintended customers immediately upon delivery to the U.S. port. Other times, documents such as bills of lading, Shippers Export Declarations (SEDs) or manifests are falsified. Some of the diverters are extremely clever in the techniques they employ to cover their tracks. In many instances, however, the diverters have either acquired or planted confederates within the company they are defrauding.

U.S. laws on diversion are less than clear, and U.S. attorneys are rarely motivated to bring criminal proceedings against individuals trading in dog food or sneakers -- especially since the goods themselves are "genuine" and the U.S. manufacturer has been paid something for their product. Nevertheless, diversion can completely wreck marketing efforts of manufacturers in the U.S. market, distort U.S. trade statistics, unhinge business plans and provide a convenient camouflage for organized crime.

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Fortunately, there are some laws and investigative techniques which have proven useful in attacking diversion in the past few years. Although most of the reported cases are civil rather than criminal, U.S. companies have been having greater success in attacking this problem than ever before. The first step in doing so, however, is to acknowledge the problem, and to retain experienced counsel to handle the matter. Sometimes, quick, effective action can result in the seizure of the products when they return to this country, and allow the company to retain the money they were originally paid by the diverter. In this case, the legal costs are effectively zero for the U.S. company, in that they get back their stolen property and keep the "flash roll" proffered by the bad guys. This of course is the ideal solution which is not often achieved, but halting diversion at all can protect a company from its pernicious effects. To the extent that a company makes it known that it will take effective action against diversion of its products, the miscreants will usually find easier victims.

It is generally critical for a company which believes it is the victim of diversion to keep this information extremely closely held to a few people within the firm. As noted above, diverters often have accomplices planted in the company itself. In this case, they can be made aware of virtually everything the company is doing to thwart the problem. In other circumstances, if the diverters are aware that they are being tracked, they can take extraordinary means to avoid detection. It is almost always the best policy to assign one or two people (usually from the General Counsels or Secretary's office) to oversee the work of outside counsel and investigators.

.Your outside consultants will usually work closely with the U.S. Customs Service to at least identify and detain the goods until either the Customs Service takes action unilaterally, convinces the U.S. Attorney to commence criminal proceedings, or reverts the case to private litigation (the most common scenario). When this occurs, counsel must move rapidly to secure Temporary Restraining Orders and Preliminary Injunctions to prevent the removal of the goods from custody. Diverters are known to be extremely facile, and can move large quantities of goods with very short notice. Allowing the goods to fall into the diverters hands once they return the United States is almost always a prescription for disaster.

The costs for an antidiversion proceeding can range from \$10,000 to twenty times that amount. As noted above, however, it is often possible to recover the entire amount of the costs by seizing the products themselves. It is almost never worthwhile, however, to count on getting damages in excess of the value of the goods and the amount already paid. Diverters are usually sophisticated criminals who have thousands of ways of concealing assets. Even if you can discover the location of these assets, they are often mobile, and expensive to collect. Stopping diversion in the first place, then, is the surest way of avoiding loss.

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