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# COUNTERFEIT GOODS: EASY CASH FOR CRIMINALS AND TERRORISTS

## HEARING

BEFORE THE

## COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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# COUNTERFEIT GOODS: EASY CASH FOR CRIMINALS AND TERRORISTS

**WEDNESDAY, MAY 25, 2005**

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Committee met, pursuant to notice, at 9:35 a.m., in room SD–562, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Lieberman, Akaka, and Lautenberg.

## OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. The Committee will come to order.

Good morning. During the past 2 years, this Committee has held three hearings to investigate terrorism financing. From the flow of money through certain Islamic charities in this country to terrorist organizations around the world, to the role played by Saudi Arabia, described to this Committee as the epicenter of terrorism financing, we have learned much about this complex and murky subject.

Today, we explore another aspect of the shadowy world of terrorism financing. The theft of intellectual property rights through counterfeiting and pirating of consumer goods is a huge and growing criminal enterprise. It is estimated that counterfeit merchandise accounts for between 5 and 7 percent of all the goods moved in world trade. According to Interpol, this counterfeit merchandise is worth approximately $450 billion annually. According to the U.S. Trade Representative, American businesses lose as much as $250 billion each year to counterfeiters.

The U.S. Bureau of Customs and Border Protection seized about $138 million in fake goods in 2004, compared with $94 million in 2003. Compact disks, computer software, sneakers, golf clubs, perfume, soft drinks, baby food, electronics, auto parts, name the product and someone is selling a bogus or pirated version on a street corner in some American city, and as you can see, we have an array of counterfeit merchandise that has been seized in various raids that is displayed on the table.

For those unfamiliar with the terminology, counterfeit goods are knock-offs or look-alikes of brand-name products, such as this counterfeit Gucci watch. Goods are referred to as pirated when criminals steal and sell the content of a legitimate product, such as the latest Star Wars movie, already out in pirated version, and copy it illegally without the permission of its owner. Both kinds of illegal goods are often referred to as counterfeit.

Combine counterfeiting's high profits with the uninformed notion that the purchase of a knockoff designer handbag, a fake wristwatch, or a pirated DVD is a victimless crime and it is no surprise that the trade in counterfeit goods is extremely lucrative. This criminal activity has damaging consequences for our economy and for honest businesses and their employees. Moreover, given the evidence that terrorists are engaging in counterfeiting to secure money to support their operations, the potential consequences are far more dire than economic damage.

The unclassified evidence linking terrorism and counterfeiting is compelling and it spans several agencies and years. For example, in a 2002 advisory entitled, "Financing Terror: Profits from Counterfeit Goods Pay for Attacks," the Customs Service warned of an increasingly close connection between transnational crime and terrorism with the profits from counterfeit and pirated goods being the strongest link.

In 2003, the Secretary General of Interpol testified before Congress that intellectual property crime, the pirating of such products as software, CDs, and DVDs, is becoming the preferred method of funding for a number of terrorist organizations. He cited direct and indirect connections between counterfeiting and Hezbollah, the Chechen rebels, extremist groups in Kosovo, and al Qaeda, among others.

Also in 2003, the Terrorist Financing Operations Section of the FBI provided a document to the Committee stating that the sale of counterfeit goods is among the ways in which Hezbollah finances its terrorist activities, and we have a graphic that takes information from this FBI report.

In its 2004 report, "Patterns of Global Terrorism," the State Department wrote that the tri-border region of South America, Argentina, Brazil, and Paraguay, is a regional hub for Hezbollah and Hamas fundraising activities, including the manufacture and movement of pirated goods.

In January of this year, the International Anti-Counterfeiting Coalition stated that there is ample evidence to confirm that terrorist organizations are profiting from the manufacture and sale of counterfeit and pirated goods.

In addition to the high profits, there is another reason that terrorists have turned to this method of financing. The United States and our allies around the world have made some significant progress in shutting off the flow of terrorist money through established mechanisms and institutions. These concerted efforts are making a difference. But we know that terrorists are nothing if not resourceful and determined. When we shut off one avenue of financing, they find another.

This point was made well recently by Treasury's Under Secretary Stuart Levy when he said, "We have indications that terrorist groups like al Qaeda and Hamas are feeling the pressure and are hurting for money. We are also seeing terrorist groups avoiding formal financing channels and instead resorting to riskier and more cumbersome financial conduits, like bulk cash smuggling. One rich source of bulk cash is the sale of counterfeit consumer products."

Finally, I would note that the focus to date by this Committee on its hearings, as well as by our government and our allies, has

been on high-level terrorist financing, for example, by multi-million-dollar charities and foundations, by entities linked to Saudi Arabia, and by Iran. That certainly is appropriate and it is where the primary focus should be. But we know that terrorism is also funded by street crime. There are many examples of this.

Ahmed Ressam, the Millennium bomber, funded his activities by stealing tourists' suitcases in hotels and by credit card fraud. In testimony before this Committee last June, the former general counsel at the Department of Treasury noted that the Madrid train bombers were financed through criminal activity, including drug dealing.

We also know that it does not take a large sum of money to commit a devastating terrorist attack. After all, the organizing, planning, and training for September 11 cost only an estimated $500,000, a sum easily generated by criminal activity such as counterfeiting.

The purpose of this hearing is to focus much-needed attention on what appears to be a fertile and growing source of financing for terrorists. It is my hope that this attention will lead consumers to reject these low-cost street corner bargains because, in fact, they carry a terrible price. It is my expectation that this attention will lead to increased efforts by our government and our allies to close off this rich avenue of terrorist financing.

Senator Lieberman.

## OPENING STATEMENT OF SENATOR LIEBERMAN

Senator LIEBERMAN. Thank you very much, Madam Chairman. Thanks so much for calling this hearing today on a problem that deserves far greater recognition than it has yet received.

Over the years, we have obviously heard much and tried to do much about the counterfeiting of consumer goods and the economic losses suffered by manufacturers whose popular CDs or designer jeans are counterfeited for mass sale around the globe. I want to compliment you, Madam Chairman. I just heard yesterday that "Return of the Sith" was already selling on the streets of Beijing, and here you have already got one, I see. Very impressive. [Laughter.]

But today, obviously, we are going to look at counterfeit goods from a different perspective, from a national security perspective, which adds, of course, a new and critical dimension to the urgency of curtailing this illicit activity, counterfeiting.

The experts estimate that as much as 7 percent of world trade is involved with the sale of counterfeit goods. That amounts to hundreds of billions of dollars a year that eat away at the income of American manufacturers and workers, but counterfeiting is obviously more than just a bunch of people hustling for a few extra bucks, a victimless crime. It has become a major source of income for organized crime and, as we shall hear today, for terrorists because of its low risks and high rewards. In other words, the risk of getting caught and the penalties if you are caught are minimal, while the potential for making money is maximal.

There is a recently published book which was called *Lightning Out of Lebanon,* which details a notorious North Carolina case a few years ago that implicated Hezbollah, the terrorist organization,

in counterfeiting here in the United States to support their activities in the Middle East. One of our witnesses here today, former FBI analyst Matthew Levitt, worked with the authors of the book and I look forward to hearing about his work in that area.

Madam Chairman, as you well know, 3 years ago, in the context of another investigation by this Committee, the Terrorist Financing Operations Section of the FBI provided an unclassified document to the Committee that listed the sale of counterfeited goods among various criminal activities the terrorist organization Hezbollah uses to raise cash in the United States. This evidence puts the lie to what I think is that commonly held belief that trade of counterfeit goods is a victimless crime. If anybody suffers, it is only a couple of big people at the top of the corporations.

That is not true. Certainly, it has never been true. But as the evidence strongly suggests that we will hear today, profits from counterfeit sales are used to finance terrorist activities, and this is anything but a victimless crime. This is a crime that finances random murder around the world, including, needless to say, the murder of Americans.

We are very fortunate today, in addition to Mr. Levitt, to have two witnesses from Los Angeles who will testify to what they have done and discovered about the counterfeit trade and its connection to terrorism. All three witnesses, I hope, will help us understand the nexus between terrorism and counterfeiting, and also help us to evaluate whether the Federal Government, State, and local governments, and law enforcement generally are receiving the resources and are coordinating their investigatory and prosecutorial activities to meet this challenge.

Local leads regarding counterfeit goods and possible terrorist connections are extremely valuable, particularly since the Federal Government has strong financial tracking capabilities with regard to terrorist financing that have been developed in recent years and were further improved by the intelligence reform legislation signed into law last year by the President, which came out of this Committee. That legislation authorized additional funding for the Treasury Department's Financial Crimes Enforcement Network and its technical tracking capabilities to strengthen the Department's anti-money laundering and anti-terrorist financing efforts.

So we know that Federal agencies track and investigate terrorist financing. What we want to find out today from the witnesses is whether those agencies are doing enough to track and investigate and prosecute those who are using the sale of counterfeit consumer goods to finance terrorist activities. This is a very important hearing today and one in which, Madam Chairman, I think we are playing another appropriate role of oversight, which may lead to legislation—perhaps we will decide that there ought to be stiffer penalties for counterfeiting—but hopefully, we will focus attention on this problem that it hasn't received before, and that attention, in turn, will engender the kind of prosecutorial activity that I believe this problem merits.

Thank you very much.

Chairman COLLINS. Thank you, Senator. Senator Akaka.

**OPENING STATEMENT OF SENATOR AKAKA**

Senator AKAKA. Thank you very much, Madam Chairman, for calling this hearing to learn more about a developing and growing problem not only in our country, but in the rest of the world, as well.

Today's hearing provides us, and I join Senator Lieberman in saying that this provides us with two opportunities. One opportunity is to understand the connection that may exist and is developing between organized crime and terrorism. The other opportunity is to, as was mentioned, evaluate the level of cooperation between the Federal level and the local level of law officials.

I want to thank our witnesses for being here to provide us with their testimony. Thank you, Lieutenant Stedman from the Los Angeles County Sheriff's Department, also Kris Buckner and Dr. Matthew Levitt for your expert testimony.

The selling of counterfeit goods pervades every major area of the United States. According to recent estimates, $286 billion in counterfeit goods are sold in the United States every year. The problem is not just large companies protecting their intellectual property and their profits. It is also consumers paying for goods they believe are of a certain quality, only to receive fake goods. It is about people buying dangerous counterfeit pharmaceuticals over the Internet, as we heard at several hearings last year before the Permanent Subcommittee on Investigations.

Interpol recently reported a tragic case of counterfeit baby formula sold in China which resulted in the deaths of 13 babies and serious illness to another 171 babies. Counterfeit goods is not a victimless crime.

Of those organized criminal enterprises that are involved in the profitable business of counterfeit goods, there is a small number who directly threaten our national security by providing financial support to terrorists.

In July 2003, the House Committee on International Relations held a hearing entitled, "Intellectual Property Crimes: Are Proceeds from Counterfeited Goods Funding Terrorism?" At that hearing, the Secretary General of Interpol, Mr. Ronald K. Noble, sounded the alarm that, and I quote him, "Intellectual property crime is becoming the preferred method of funding for a number of terrorist groups."

Department of Homeland Security Under Secretary Hutchinson said, "Terrorist organizations worldwide are looking for a variety of illegal activities to fund their efforts. They have looked at contraband and counterfeiting and piracy, all as means of illegal activity to fund their organizations."

One well-known case involving counterfeit and pirated goods was reported in the joint Departments of Justice and Treasury in 2003 National Money Laundering Strategy, working with Canadian law enforcement. U.S. officials obtained 18 convictions of members of a Charlotte, North Carolina-based Hezbollah cell which had smuggled untaxed cigarettes into North Carolina and Michigan and used the proceeds to provide financial support to terrorists in Beirut.

There is a danger that, over time, terrorist cells and criminal gangs could forge mutually beneficial financial links that will facilitate terrorist infiltration into the United States. It is one short step

from smuggling narcotics to smuggling terrorists and explosives. Once this link is made, that challenge to our domestic security will have exponentially increased.

Some concern has already been reported about possible connections between al Qaeda and the street gang known as MS–13. While these connections appear now not to have been made, our vigilance must be strict. It illustrates the important need for cooperation between criminal intelligence divisions in the local law enforcement field and terrorist intelligence agencies at the Federal level.

Madam Chairman, I hope today's witnesses will address some of these issues, and I hope, Madam Chairman, that the Committee will continue to look into these issues. I ask to be excused for another important Committee statement that I have to make elsewhere. Thank you very much.

Chairman COLLINS. Thank you, Senator. You are a very dedicated Member of this Committee, and I appreciate your coming by this morning.

Senator AKAKA. Well, it is no secret. I enjoy working with you.

Chairman COLLINS. Thank you. Senator Lautenberg.

**OPENING STATEMENT OF SENATOR LAUTENBERG**

Senator LAUTENBERG. Thank you, Madam Chairman. It is pretty obvious that we must do whatever we can to interrupt funds that might go to terrorist organizations or countries that support terrorism, and today, we are looking at one way that funds are developed to support these enemies of the United States.

We have all had the experience, as we talk about counterfeit goods, we have all had the experience of walking down streets in cities like Newark, New York, Philadelphia, or any other major city and see people selling items like handbags, clothing, and the miscellaneous replications that we see here on this table and that we are all aware of. At first glance, these items might appear to be a great bargain.

But most of us have learned that when a deal seems too good to be true, it usually is, and that is certainly the case with counterfeit consumer goods. They are a bad deal for consumers because they don't really receive what they think they are buying. And counterfeit goods are certainly a bad deal for the companies whose goods they mimic.

That is one part of the thing. The result is, as we look at today, is not only does it hurt the economy, hurt the companies, and hurt the buyers, but it appears that trade in counterfeit merchandise might even damage our national security by funneling money into the hands of terrorists.

President Bush has said it, that money is the lifeblood of terrorists, and that is certainly true. We have learned that. But there are other larger sources of income to terrorists that are also not being shut down, and one that I have focused on in the past is American companies that do business with terrorist States.

That is why I have introduced a bill that would close the loophole in our current law that allows U.S. companies to do business with nations like Iran, simply by going through offshore subsidiaries.

Now, we need to close this loophole and cut off the flow of dollars to terrorists, people who want to destroy our lives and our Nation.

I look forward to hearing more about the issue of counterfeit goods from our witnesses. It is my hope that my colleagues will join with me to stop U.S. companies from doing business with terrorists once and for all. We have got to do whatever we can to make sure that no help goes from any American company by any device or ruse to countries like Iran, where funds travel to terrorist organizations, wind up killing or injuring Americans, whether or not they are in or out of uniform, and I commend you, Madam Chairman, for calling this hearing and focusing on this issue of funds to terrorists.

Chairman COLLINS. I would now like to welcome our first panel—our only panel this morning, of witnesses. Each is truly an expert in his field. Lieutenant John Stedman is a 24-year veteran of the Los Angeles County Sheriff's Department and is currently a supervisor in the Criminal Investigative Section of the Department.

Kris Buckner is President of Investigative Consultants, a private investigation firm specializing in intellectual property crime investigations.

And Dr. Matthew Levitt is an expert on the subject of Hezbollah. He is also the Director of the Washington Institute's Terrorism Studies Program.

We are very pleased to have you here with us this morning. We appreciate all of the prior assistance you have given the Committee as we have investigated this issue.

Lieutenant, we are going to start with you. Thank you.

## TESTIMONY OF JOHN C. STEDMAN,[1] LIEUTENANT, SHERIFF'S DEPARTMENT, COUNTY OF LOS ANGELES

Lieutenant STEDMAN. Thank you, Chairman Collins and Senator Lieberman, for the opportunity to testify today. My name is John Stedman. I am a lieutenant with the Los Angeles County Sheriff's Department in California. My testimony today will address the enforcement efforts of the Sheriff's Department regarding intellectual property rights crimes and the involvement of organized crime groups operating in Los Angeles county.

My experience with IPR crimes dates to the late 1980s, when my unit was approached by members of the Latin American Music Association. They were experiencing large revenue losses due to proliferation of unauthorized and illegal duplication of music onto cassette tapes. The Music Association was seeking cooperation from local law enforcement to enforce a State of California statute that makes it a crime to illegally duplicate copyrighted or trademarked materials. Over the next 2 years, my unit investigated dozens of these cases, resulting in the seizure of hundreds of thousands of cassette tapes and the incarceration of many suspects.

During the 1990s, the Motion Picture Association of America also requested the services of local law enforcement to enforce the same copyright or trademark statutes of California. Detectives under my supervision completed many of these investigations, seizing thou-

[1] The prepared statement of Lieutenant Stedman appears in the Appendix on page 31.

sands of illegally duplicated motion pictures. Many of these videos were of films not yet released to the theaters.

In 2003, I was assigned to supervise the Criminal Investigations Section of the Emergency Operations Bureau. It was at this time that I gained a full realization of the pervasiveness of IPR crimes in Los Angeles County. We concentrated our investigative resources on IPR crimes and have uncovered significant organized criminal enterprises operating within Los Angeles County. Victims of the organized criminal groups include the tobacco industry, luxury goods manufacturers, clothing companies, and the music and motion picture industries. Information in open sources indicates that across the globe, anything that has a decent profit margin is being counterfeited.

While there are no local statistics on the magnitude of the problem, I can relate what my small team of one sergeant and six investigators has accomplished in a little more than a year. We have served 60 search warrants, which have yielded 125 arrests and $16 million in seized counterfeit products. An additional $3.5 million in cash has been seized and is currently in forfeiture proceedings. With your permission, Madam Chairman, I would like to show a short video which illustrates one of our warrant operations.

Chairman COLLINS. Please do.

[A videotape was played.]

Lieutenant STEDMAN. Within the Sheriff's Department, there are units designated to combat organized criminal enterprises, such as the one you just saw, and we are represented on nearly every task force created to investigate these groups.

These units have similar experiences with IPR investigations, noting that the profits are enormous with minimal criminal exposure. Russian organized crime, Eurasian organized crime, Asian organized crime, and Lebanese organized crime groups all profit from IPR crimes.

Additionally, we believe that there may be a trend developing for local gang involvement in IPR criminal activity. Recently, we have investigated several individuals with strong gang ties and extensive criminal records. During interviews, these suspects have admitted that IPR crime is attractive because of the high profit and minimal jail sentences. In the parlance of one suspect, it is better than the dope business. No one is going to prison for DVDs.

There are also indicators that some associates of terrorist groups may be involved in IPR crime. During the course of our investigations, we have encountered suspects who have shown great affinity for Hezbollah and its leadership. The following are just two examples.

During the service of a search warrant in which thousands of dollars in counterfeit clothing was seized, I saw small Hezbollah flags displayed in the suspect's bedroom. Next to the flags was a photograph of Hassan Nasrallah, whom I recognized as the leader of Hezbollah. The suspect's wife asked me if I knew the subject of the photograph. I identified Nasrallah and the wife said, "We love him because he protects us from the Jews." Also in the home were dozens of audio tapes of Nasrallah's speeches. During the search, one of my detectives also found a locket which contained a picture of the male suspect on one side and Sheik Nasrallah on the other.

In 2004, detectives served an IPR search warrant at a clothing store in Los Angeles County. During the course of the search, thousands of dollars in counterfeit clothing was recovered, as were two unregistered firearms. During the booking process, the suspect was found to have a tattoo of the Hezbollah flag on his arm. To my left is a photo of that tattoo.

Again in 2004, detectives served a multi-location IPR-related search warrant involving a large-scale counterfeit blanket operation. During the course of the investigation, detectives located a photo album. Within the photo album were dozens of pictures of attendees at a fundraising event for the Holy Land Foundation. When questioned about the album, the suspect said that the Holy Land Foundation was not a terrorist funding operation. When I informed the suspect that the U.S. Government had shut down the charity because of its alleged support of Hezbollah, the suspect replied that the U.S. Government was stupid and would do anything that the Jews told them.

When confronted with these indicators, we passed the information immediately to the Los Angeles Joint Terrorism Task Force for further review. As a result of this kind of information sharing, we enjoy an outstanding relationship with the JTTF as well as with the other three FBI offices located in Los Angeles County.

As I have stated, the financial rewards of IPR crimes are immense. Many times, the biggest issue for the criminal or his group is how to disperse the money generated from the crimes committed. It is difficult to use traditional banking practices to account for the huge profits generated. In one of our cases involving counterfeit baby blankets, we discovered over $800,000 in cash located throughout the suspect's residence, hidden in trash bags, under beds, stuffed in trash cans, and stashed in the attic. In fact, more than $10,000 was found in a child's piggybank.

On other occasions, we have seen activity consistent with money laundering and structuring occurring between similar businesses.

Another of our cases began with the stop of a suspect at Los Angeles International Airport by U.S. Customs officers. Strapped to the suspect's body was more than $230,000 in cash. The suspect told the Customs officers that she was en route to Lebanon for a vacation. Information was developed that the suspect owned a chain of cigarette shops. Service of search warrants led to the seizure of more than 1,000 cartons of counterfeit cigarettes, an additional $70,000 in cash, as well as wire transfers to banks throughout the world.

The financial cost of IPR-related crimes to the State of California is significant. As an example, my small team has seized about 40,000 cartons of counterfeit, untaxed cigarettes. The California State tax on cigarettes is $8.70 per carton, representing a loss to the State of $348,000.

It should also not be a surprise to anyone that suspects involved in IPR crime do not concern themselves with paying appropriate taxes, whether Federal, State, or local. Our experience has been that suspects claiming $20,000 or $30,000 on their yearly income tax forms routinely keep tens of thousands of dollars in cash at their homes.

The Los Angeles County Sheriff's Department has, like most local agencies, suffered cutbacks in personnel over the past several years due to severe budget curtailments. There has not been a mechanism to address IPR crimes other than that based on interest from small units or individual investigators. We believe that there is a critical void in personnel to mount an effective campaign against the criminal enterprises that utilize IPR as a revenue stream. It is well-documented that organized criminal enterprises engage in IPR crimes. There are mounting indicators of the involvement of terrorist groups and their supporters.

In Los Angeles County, we believe there should be a task force commitment in order to combat the problem. Members of the Sheriff's Department have begun to explore different sources of revenue to fund such a task force in our region. The private sector has shown interest in contributing to such an effort. In fact, the private sector, comprised of manufacturers and companies such as Investigative Consultants, whose President, Kris Buckner, is speaking today, plays a vital role in our enforcement efforts. Without this cooperative public-private sector relationship, the Sheriff's Department, because of limited personnel resources, would quickly be overwhelmed and would not be able to maintain our current investigative pace.

We also believe that there should be legislation to enact or increase the levy on containers shipped through the ports of Los Angeles and Long Beach. These levies would fund intensified IPR enforcement efforts. It is my hope that by drawing more attention to this crime, we can reinforce the American dream of having an idea, bringing it to market, and profiting from its success without interference from the criminal element.

On behalf of Los Angeles County Sheriff Leroy D. Baca, I wish to thank the Committee for this opportunity to represent our county in discussing this important topic. Thank you, and I look forward to any questions you might have of me.

Chairman COLLINS. Thank you, Lieutenant. Mr. Buckner.

## TESTIMONY OF KRIS BUCKNER,[1] PRESIDENT, INVESTIGATIVE CONSULTANTS

Mr. BUCKNER. Thank you. I would like to thank Chairman Collins, Senator Lieberman, and all of the Members of the Committee for the opportunity to appear before you today. Intellectual property crime is an important topic, and I am very pleased that the Committee is holding this hearing to discuss how intellectual property crime affects our country, including the possibility that proceeds from counterfeiting fund terrorism.

For the record, my name is Kris Buckner. I am the President of Investigative Consultants, a licensed private investigative firm based in Southern California. I have been a private investigator for over 10 years and specialize in investigations involving manufacture, distribution, and sale of counterfeit goods.

Investigative Consultants began as a single-person operation in 1994. The company now employs 14 full-time employees and several part-time and contract employees. Ninety-five percent of the

[1] The prepared statement of Mr. Buckner appears in the Appendix on page 35.

company's time is spent investigating intellectual property matters, and we currently represent over 80 different brand owners.

The job of our company is to work on behalf of brand owners to uncover evidence of counterfeiting activities. When we find concrete evidence that some person or group is substantially engaged in counterfeit goods marketing, we contact the appropriate law enforcement agency and provide them with the evidence and assist them on behalf of the brand owners in the identification, inventory, and storage of the counterfeit items to ensure that the counterfeiters are brought to justice.

How big is the problem of counterfeit goods? Let me answer that in three words. Out of control. In only 10 years, my company has conducted over 9,000 intellectual property investigations that have resulted in the recovery and seizure of over $1 billion worth of counterfeit and pirated merchandise.

Over the past 10 years, our investigations have helped law enforcement arrest over 3,000 people for counterfeiting and piracy. There is no end in sight. My business continues to grow.

I would like to show a short video that illustrates the problem, with your permission.

[A videotape was played.]

Mr. BUCKNER. What you are looking at here is a search warrant getting served at an embroidery factory that contained two sophisticated embroidering machines that were embroidering counterfeit clothing. Each of those machines is worth about $250,000.

What you are looking at now is video footage of an LAPD search warrant of a warehouse that contained counterfeit handbags. The operator, who was subsequently convicted of trademark counterfeiting, advised law enforcement that he was making $30,000 cash per week in this business and had retired from a nine-to-five job at Northrup because this was so lucrative.

What you are looking at now is a DVD lab that is manufacturing counterfeit and pirated movies. Those are finished movies there that you are looking at. This lab has the capability of manufacturing tens of thousands of counterfeit movies per week, and those are the computer tower burners that are used to manufacture the movies themselves.

The counterfeiting problem is not just limited to handbags, watches, and other luxury goods. I have been involved in cases involving DVD movies, music CDs, glue, children's toys, sunglasses, food items, computer equipment, toner products, and numerous other items. I have also seen cases where brake pads, aircraft parts, baby formula, and even cough syrup have been counterfeited. You name it and criminals can and will counterfeit it. As long as counterfeiters are making money, they do not care who they hurt or kill.

Most brand owners go to great lengths to combat the problem. One of the ways in which they do this is hire people like me to serve cease and desist notices on people we know are engaging in the sale of counterfeit merchandise. I have served thousands of these notices.

In my hand is what we call our subject book. This is just one of five such binders, all of which are as big or bigger than this one, that are kept in my office. These binders all contain photographs

of people that we have served with the cease and desist notices. Ninety percent of these vendors continue to sell counterfeit merchandise, even after we advise them what they were doing was illegal. They continue their operations because of the large amount of money that they make.

And make no mistake about it, counterfeiting is profitable. I have participated in multiple law enforcement operations in which huge sums of cash have been recovered. During one such raid, officers found over $370,000 in cash in a decrepit warehouse. That money was just some of the profits enjoyed by a subject who had merely been selling counterfeit blankets.

Some counterfeit goods are manufactured in the United States. While assisting law enforcement, I have seen California factories involved in the large-scale manufacture of counterfeit merchandise. I have been involved in cases in which owners of factories routinely locked employees inside the manufacturing facilities. Law enforcement had to call the fire department, which used the Jaws of Life to cut open the doors and free the employees. If there had been a fire, the employees would have died. Counterfeiters valued cash more than human life.

The vast majority of counterfeit merchandise is manufactured outside the United States in countries like China, South Korea, Taiwan, and Mexico. The merchandise is often manufactured under unsafe conditions, and there have been cases where counterfeiters used child labor to make products.

Counterfeiters often smuggle goods into the United States. Several times, I have come across brand-name counterfeit handbags sewn inside the linings of generic handbags. Once the generic handbags pass Customs, counterfeiters cut open the generic handbags and remove the counterfeit ones.

Lieutenant Stedman is going to show us a perfect example of one of these bags I just spoke about, where you look at the outside and it looks like a generic, non-descript handbag. But you cut open the lining of the bag and you will see what is inside. And inside, you have the counterfeit. It may seem like a lot of work to smuggle counterfeit handbags, but keep in mind that a counterfeiter can make approximately $500,000 in cash per container.

It is wrong to think that counterfeit merchandise is only sold on the street corners. Counterfeit merchandise regularly ends up in all types of stores, including large chain department stores, hotel gift shops, upscale boutiques, swap meets, flea markets, and other retail locations.

There is a shopping district in Los Angeles called Santee Alley, where counterfeit merchandise is openly sold. On any given day, there are over 75 vendors in Santee Alley selling all kinds of counterfeit merchandise.

I am frequently asked whether I believe organized criminal groups engage in the sale of counterfeit and pirated merchandise, and my answer is yes. Sometimes, an organized counterfeiting operation profits primarily from the sale of counterfeit goods, whereas in other instances, counterfeiting is just another revenue stream for the criminal syndicate.

In Los Angeles, the various criminal groups profiting from the sale of counterfeit goods are extremely well organized. They hire

lookouts, utilize countersurveillance techniques to track my employees' activities and the activities of law enforcement. The groups use two-way radios and have also developed an elaborate warning system to alert vendors of impending enforcement actions.

During heavy enforcement periods, counterfeiters have placed lookouts near the Los Angeles Police Department's Central Division to monitor the movements of law enforcement. Counterfeiters have surveiled my team of investigators. They have also been spotted surveiling our office location. During counterfeit goods raids, I found lists containing the names of my employees, their physical descriptions, descriptions of our company vehicles, and license plate numbers.

Counterfeiters are making so much money that they will do anything to disrupt our efforts. My investigators have been assaulted by counterfeiters. Counterfeiters have slashed the tires of our vehicles. A counterfeiter injured one of my investigators when he broke out the window of the investigator's vehicle while the investigator was driving it.

There is clear and convincing evidence that street gangs have begun to profit from the sale of counterfeit merchandise on the streets of Los Angeles. Not only do the gangs place their soldiers on the street to sell pirated movies and music, they attack other street vendors who want to sell counterfeit merchandise on their turf. It only stands to reason, then, that the proceeds from the sale of counterfeit goods are used to buy guns and drugs.

More and more organized criminal groups are engaging in the sale of counterfeit merchandise to raise money. The great profits and the limited risk of prosecution make it an extremely attractive enterprise. For these criminals, it is simply a matter of business. They get caught selling drugs, they go to prison. They get caught selling counterfeit goods, they get probation.

I am also frequently asked if terrorist groups profit from the sale of counterfeit goods. I do not know the answer to that question. What I do know is that while working with law enforcement to conduct counterfeit goods raids, I have been in homes and businesses in which photos of Hezbollah Sheik Nasrallah have been prominently displayed. On several occasions during these same raids, I have heard subjects make anti-Israeli and anti-Jewish statements. I have also observed evidence indicating that counterfeiters send large amounts of money to places such as Lebanon and Paraguay.

My company is hired by major corporations, and I know that many people don't have any sympathy for big businesses. However, the public needs to understand that they are forced to pay higher prices for brand-name products because of counterfeiters. It has been estimated that counterfeiting costs brand owners billions of dollars a year in lost revenue. Brand owners must raise their prices to recoup those losses.

In my opinion, the general public has no appreciation for how many mom-and-pop retail establishments are driven out of business every year by counterfeiters. As everyone knows, there is great demand for brand-name products. How can a legitimate small retailer compete when consumers have the option of buying a $20 pair of generic sunglasses in their store or a $20 pair of brand-

name counterfeit sunglasses in the store next door? Far too many consumers buy the counterfeit brand-name sunglasses.

Time and again, I receive calls from legitimate small business owners begging me to investigate their counterfeit competitors. These people know that they will quickly be driven out of business if the seller of the counterfeit goods is allowed to continue to operate next door to them. There is nothing more rewarding than receiving a congratulatory phone call from these same small business owners after participating in a counterfeit goods raid with law enforcement.

In closing, I would like to say that although I am not an expert on organized crime and terrorism, I do know how the counterfeit goods operations work, and every day in the course of my investigations, I see things that strongly suggest that terrorist groups are raising funds through the sale of counterfeit goods. The opportunity is there and the indicators are there. The sale of counterfeit goods is not a victimless crime.

I again want to thank the Committee for holding this hearing, and I would like to acknowledge the outstanding efforts of the law enforcement agencies in California, especially the Criminal Investigations Section of the Los Angeles County Sheriff's Department and the Los Angeles Police Department. They understand the importance of aggressively pursuing counterfeiters.

Thank you, and I look forward to your questions.

Chairman COLLINS. Thank you. Dr. Levitt.

**TESTIMONY OF MATTHEW LEVITT,[1] SENIOR FELLOW AND DIRECTOR OF TERRORISM STUDIES, THE WASHINGTON INSTITUTE FOR NEAR EAST POLICY**

Mr. LEVITT. Thank you, Madam Chairman, Senator Lieberman, and Members of the Committee. I am grateful for having the opportunity to testify before you today.

What I would like to do is to put Lieutenant Stedman's and Mr. Buckner's testimony into context in terms of what Hezbollah's modus operandi is. First, let us understand what Hezbollah is all about. Aside from suicide truck bombings targeting U.S. and French soldiers in Beirut in 1983 and 1984, Hezbollah is also behind the Khobar Towers bombing in Saudi Arabia in 1986, two sets of bombings in Argentina in 1992 and 1994, attempted bombings in Thailand in 1994, attempted attacks in the streets of Singapore, and many other attacks internationally targeting American, French, German, British, Kuwaiti, Bahraini, and other interests worldwide.

According to U.S. authorities, concern over the threat posed by Hezbollah is very well placed. FBI officials have testified that Hezbollah continues to have subjects based in the United States and have the capability to attempt terrorist attacks here should this be the desired objective of the group. Hezbollah continues to surveil U.S. interests internationally and in the United States. Former CIA Director George Tenet testified in 2003 that Hezbollah, as an organization with capability and worldwide presence, is al Qaeda's equal, if not a far more capable organization.

[1] The prepared statement of Mr. Levitt appears in the Appendix on page 41.

Therefore, anything it is doing to fund its activities should be our concern, and I commend the Committee for holding this hearing in the context of its national security implications.

Iran is believed to fund Hezbollah to the tune of at least $100 million a year. But the group is also believed to engage in all kinds of other fundraising techniques through charities, but perhaps most importantly and most successfully through criminal enterprises, and I would like to focus on that criminal enterprise aspect.

Consider just a few examples, because in the open source world, there is only so much detailed information available to us. But in the Charlotte case that Senator Lieberman mentioned earlier, of which I was the government's expert witness, law enforcement authorities were able to trace half-a-million dollars through various accounts tied to the cell members. They believe most of the funds, however, remained in cash. There was approximately $1.5 million to $2.5 million in profit made on $8 million of cigarettes that were smuggled. Of this, tens of thousands of dollars—some investigators still maintain it may be closer to hundreds of thousands of dollars—were never found and are suspected of going to Hezbollah beyond the funds that they can demonstrate went to Hezbollah.

U.S. officials believe a substantial portion of the estimated millions of dollars raised by Middle Eastern terrorist groups in the United States comes from the $20 million to $30 million annually brought in by the illicit scam industry here in the United States. Of the Middle Eastern terrorist groups present in the United States, Hezbollah is far and away the most criminally oriented, and so we need to assume that the vast majority of that activity is being carried out by Hezbollah cells in this country, and there are several.

In South America in the tri-border area, it is especially important to Hezbollah. There are criminal enterprises. The group there raises close to $10 million a year, according to a study by the U.S. Naval War College. According to that report, U.S. Southern Command estimates that the Islamist terrorist groups, including Hezbollah, raised between $300 million and $500 million per year in the Triple Frontier and the duty-free zones of the Iquique, Colon, Maicao, and Margarita Islands.

Hezbollah also raises tremendous amounts of money through foreign expatriate remittances, and this is also tied to criminal activity. For example, in 1988, Lebanese expatriots in Senegal attempted to smuggle approximately $1.7 million to Lebanon. At the time, the local community claimed that the smuggling operation was not intended to fund Hezbollah but merely to evade Senegalese law. It appears that it was intended to both evade Senegalese law and finance Hezbollah. Israeli intelligence, according to one Israeli report, ranks Senegal as the second most important center in Africa for Hezbollah financing after the Ivory Coast.

Similar activity has been documented in South America, where Hezbollah funds are raised through criminal enterprises and then sent back to Lebanon as foreign remittances, or under the cover of foreign remittances.

A senior U.S. law enforcement official noted that, "there is a significant amount of money moved out of the United States attributed to fraud that goes to terrorism." The most outstanding case

that we know about is the case in Charlotte, North Carolina, where two brothers, Mohammed and Chawki Hamoud, led a cell in Charlotte, North Carolina, with a parallel part of the network in Canada. Investigators reviewed over 500 bank, credit card, and other financial accounts.

Some members used multiple identities. For example, they would simply buy-out the identity of Middle Eastern students who had been studying at the University of North Carolina-Charlotte and use those legal identities under the names like Ali Abu Sala or Hassan Shavski. They had several legitimate driver's licenses, INS work authorization cards, Social Security numbers. Each of these individuals had multiple identities. Said Harub, one of the cell members who turned evidence against his fellow cell members, had three legitimate driver's licenses, over a dozen other I.D.'s with which he established credit and busted out that credit at the $150,000 limit and then did it over and over again.

The bottom line is that every member of this cell, this network, entered the country illegally, stayed here illegally, committed crimes while they were here, and sent the proceeds back to Hezbollah.

In Canada, where the network procured dual-use technologies, like night-vision goggles, for Hezbollah, some of the material was bought with funds that were sent from Lebanon. Some of the material, however, was bought through credit card scams. And to make matters worse, Hezbollah would still pay the cell members 50 cents on the dollar so that they made profit on the material that they were procuring for Hezbollah. It is a typical modus operandi for Hezbollah, where individual cell members are often out for the money, which is one of the reasons they are so interested in criminal activity.

In a particularly disturbing case, the Canadian part of the network talked about—there is no evidence that it actually did—taking out life insurance policies for suicide bombers in Southern Lebanon—this was just before the Israeli withdrawal in 2000—taking out life insurance policies for suicide bombers who would then attack Israelis and then cashing in those life insurance policies in Canada.

Hezbollah and other terrorist groups also traffic narcotics in North America. A DEA investigation into a pseudoephedrine smuggling scam in the American Midwest led investigators as far as Jordan, Yemen, Lebanon, and other Middle Eastern countries, including bank accounts tied to Hezbollah and Hamas. Then-DEA Chief Asa Hutchinson confirmed that a significant portion of some of the sales are sent to the Middle East and used to benefit terrorist organizations.

In South America, Hezbollah operatives engage in a wide range of criminal enterprises to raise, transfer, and launder funds in support of their terrorist activities. In one case, Paraguayan officials arrested Ali Khalil Mehri, a Hezbollah operative, for selling millions of dollars in pirated software and funding Hezbollah with some of the profits.

Assad Barakat, one of the most important Hezbollah operatives in South America, not only served as a treasurer for Hezbollah, but was also involved, according to their investigation, in a counter-

feiting ring that distributed fake U.S. dollars and generates cash to fund Hezbollah operations. He personally cleared contributions to Lebanon for Hezbollah.

Hezbollah operatives also run otherwise legitimate business enterprises that function as shell companies or fronts for raising, laundering, and transferring large sums of money. For example, the Charlotte cell members used some of the money they raised to buy a BP gas station, funded in part with a loan from the Small Business Administration. Mohammed Hamoud, the cell leader, wondered to his wife at the time what kind of background investigation would be required, and when she asked why he was so concerned, he said, "There are some things about me you are better off not knowing."

According to Israeli officials, Hezbollah operatives run several Western Union offices in Lebanon and use the co-opted services of others worldwide. In some cases, they actually run the offices and skim some of the 7 percent service fee charge, which they split between themselves as profit and for Hezbollah.

In at least one case in the United States involving Western Union, in January 2002, a case in Burbank, Illinois, three Middle Eastern men sent hundreds of thousands of dollars to Turkey, Germany, and the United Arab Emirates. There is no known terrorist link to that investigation, though it was never fully investigated and it remains an open question.

According to a former senior law enforcement official, and I quote, "Hezbollah is very criminally oriented for its fundraising in the United States, including legitimate and illegitimate business activities." Despite all the money the group receives from Iran, Hezbollah activists in the United States are believed to be self-funding, mostly through criminal enterprises, including counterfeit goods.

The extent of Hezbollah counterfeit activity in South America, of which we know a great deal, combined with the group's known presence in this country and its predilection for engaging in fraud and other criminal activity in this country, point to the group's likely deep involvement in counterfeit activity in the United States.

I thank you for having me here to testify and I look forward to answering any questions you may have.

Chairman COLLINS. Thank you for an excellent statement.

I want to thank all of you for adding to our knowledge of this important subject. When most consumers look at counterfeit goods, such as those displayed on the table, I think they believe, oh, it doesn't matter if it is fake. It is kind of fun to have one and I am going to buy it. I hope through this hearing today that we can help increase public awareness of just what the consequences are of buying counterfeited goods, that it isn't some kind of lark, but rather that the proceeds not only harm legitimate businesses and their workers, but even more troubling, are being used for criminal and terrorist activities. So one of the reasons I wanted to hold this hearing is to try to get consumers to think twice before purchasing counterfeited or pirated goods.

Dr. Levitt's statement talked about Hezbollah targeting Americans around the world, and indeed, the 9/11 Commission found that prior to the attacks on our country by al Qaeda on September

11, that Hezbollah was responsible for killing more Americans than any other terrorist group.

Lieutenant Stedman, you noted in your opening statement that one of the individuals you arrested for the sale of counterfeit goods had a Hezbollah logo tattooed on his arm, and you pointed to the picture, which we have blown up. Could you walk us through what is on the tattoo, since many of us are not familiar with the symbols and the Arabic script?

Lieutenant STEDMAN. I had the Arabic examiner for the Sheriff's Department take a good look at it and this is what he interpreted to me. The bottom script, underneath the green, in the Arabic writing would be translated as "The Islamic Revolution of Lebanon," and you have the upraised arm, fist, holding the assault weapon. The script above that was translated as saying "Hezbollah are the Winners," and then the dome you see at the top is a temple mount or—the disputed dome in Jerusalem. Pretty much, that is the same picture, Hezbollah logo that you see on the flags and all the other paraphernalia that we run across.

Chairman COLLINS. And you have also found, I understand, audio tapes that contain the speeches of Hezbollah's leader. Is this an isolated occurrence, or have you seen this evidence and audiotapes during other raids on counterfeit operations?

Lieutenant STEDMAN. We have seen those on numerous occasions, both in the residences that we go to and the businesses. I have seen thousands of those tapes all over.

Chairman COLLINS. You have seen thousands of those tapes?

Lieutenant STEDMAN. Yes, ma'am.

Chairman COLLINS. Dr. Levitt, you mentioned that Hezbollah is operating in the United States in cells. What do you think are Hezbollah's objectives in the United States?

Mr. LEVITT. Hezbollah, like Hamas and most other groups in this country, with extended continued presence in this country, take advantage of the freedoms in this country and use the United States primarily as a cash cow to engage in fundraising through charities and, of course, as we have discussed today, through criminal activities.

I should note that in the Charlotte case, it was the same exact thing, tremendous amounts of Hezbollah material were found all over the place.

The FBI has testified before Congress in the past, however, that Hezbollah operatives are also known to surveil potential targets in this country. The FBI has assessed that those activities are primarily used to vet new recruits, but the fact is that they then have that surveillance report available for off-the-shelf use, and the FBI has also testified, as I mentioned earlier, that Hezbollah has the capability to conduct attacks, should it be their desire to do so. So it is a tremendous concern to us.

We know that Richard Reid, for example, the infamous shoe bomber, was sent on a similar vetting mission, including going to Israel and other places, and that his report was found in Afghanistan. That report was available to al Qaeda later should they want to use it for attacks, as Hezbollah would be able to use vetting reports, reports from vetting operations where new recruits are asked to surveil targets here.

Chairman COLLINS. Mr. Buckner, you have mentioned that you have an excellent partnership with law enforcement, and that is obviously critical. Have you learned during the course of your investigations whether individuals that you are looking at for intellectual property crimes are also the subject of investigations by other law enforcement groups, particularly the FBI?

Mr. BUCKNER. Yes, ma'am. On numerous occasions when we have conducted even civil enforcement actions at a location, I have received several calls from the FBI asking me about our activities and what we were doing at locations, and this has happened to us numerous different times.

Chairman COLLINS. Have you seen any evidence of wire transfers to Lebanon?

Mr. BUCKNER. Yes. During my 10 years of doing this, I have seen tremendous amounts of wire transfers going to both Lebanon and Paraguay, it seems like is one of the countries of choice.

Chairman COLLINS. Lieutenant Stedman, what about you? Have you seen evidence of wire transfers and other ways to get funds from the United States from these counterfeit goods to Lebanon and the three-state area in South America?

Lieutenant STEDMAN. My experience has been that—I don't have a lot of experience in the three-state area, but we do see wire transfers, both Western Union and bank transfers, from the States to—I have seen them to Jordan, Lebanon, Syria. They are very common. As Kris said, we see them almost everywhere we go.

Chairman COLLINS. And one final question for the three of you before I yield to my colleague. In addition to educating consumers that by their purchases of counterfeited or pirated goods, they may well be supporting terrorist activities, what more do you think we should be doing to assist law enforcement in cracking down in this area, or beyond law enforcement? What steps would you recommend that this Committee encourage? I will start with Dr. Levitt.

Mr. LEVITT. Perhaps one of the most useful discussions could be about potential punishment for this type of activity. As my colleagues have discussed, there basically is none. In other areas, I know, and there may be in this already, I am not an expert on the legal side, but terrorism enhancements, and if there are not terrorism enhancements for this type of activity, that is something we should definitely consider. It should be.

Senator LIEBERMAN. You mean enhanced penalties?

Mr. LEVITT. Yes, sir. It should be considered a worse crime if you are doing something that is not only illegal but is also supporting terrorism, even if we can't meet the threshold of the material support statute, which has very technical thresholds that need to be met.

The other thing I think we are already well along in doing, and both my colleagues have highlighted this, and in Los Angeles, it certainly sounds like it is working very well, and that is the local law enforcement and FBI JTTF cooperation. Again in the Charlotte case, this started with an off-duty sheriff who came across a case. In that case, however, there was not direct communication with the FBI at that time. It is only when they went to the U.S. Attorney's Office with their case. Then the FBI came to the U.S. Attorney's

Office and said, do you see this slide? They said, yes, that is our cigarette smuggling ring. And then they showed them another slide of identical people and said, well, this is our Charlotte Hezbollah cell, and they decided at the U.S. Attorney's Office level to make this much more than just a smuggling fraud case.

If we can get the cooperation at a much lower level, like Lieutenant Stedman said is common in his jurisdiction, I think we can do a lot more to prevent this activity.

Chairman COLLINS. Thank you. Those are very helpful suggestions.

Mr. Buckner.

Mr. BUCKNER. I think public education is the most important key, as you stated previously. We have to kill the demand for the counterfeit goods, and we really do have to educate the public on where the proceeds go and that it is not a victimless crime. Though I represent the brand owners and that is how I make my living, there are a lot of mom-and-pop retail folks out there that are trying to make a living that get killed by the counterfeiters out there.

Chairman COLLINS. Thank you. Lieutenant Stedman.

Lieutenant STEDMAN. I agree with what both of my colleagues have said. I would only add that we have had some contact with the Department of State, and this is way out of my realm of expertise, but some pressure put on the countries that are manufacturing all these goods, specifically in my experience China, would be helpful, to stem the flow at the other end.

Chairman COLLINS. That is another good suggestion. Thank you very much. Senator Lieberman.

Senator LIEBERMAN. Thanks, Madam Chairman. Thanks to the witnesses. Your testimony has been excellent, I think.

Let me ask you a few factual questions just to make sure I am clear of how this is happening, and to go really to the beginning of the counterfeiting operations themselves. This is not the kind of stuff that you can do in your living room or your basement. I mean, I suppose if you had enough sophisticated equipment, you could, but what I am saying is it is real manufacturing. You have got to have the semblance of a business.

So my question is, who is doing it at that level? Are these just entrepreneurs here in the United States or Asia or other parts of the world, or is there organized criminal involvement at the level of the counterfeiting itself? I will start with anybody. Mr. Buckner.

Mr. BUCKNER. In regards to certain different types of counterfeit goods, whereas DVDs and CDs can be mass produced in a small apartment—in fact, in my experience in Los Angeles, most of the labs that we come across are based out of small apartments.

Senator LIEBERMAN. Right. Though as you said, or somebody did, you still have to have a pretty expensive set of equipment to do it.

Mr. BUCKNER. Yes, sir. You are probably looking at about $10,000 worth of computer towers, printers, things of that nature, and you can really set up a nice operation that can——

Senator LIEBERMAN. Actually, that is relatively inexpensive compared to the profit. I guess I was thinking about the quarter-of-a-million dollars that was the other video.

Mr. BUCKNER. Yes, the different goods will dictate how your operation needs to be set up. An embroidery factory, as we saw in the

videotape, you do need a warehouse-type facility to house those machines and it takes a large-scale operation.

Senator LIEBERMAN. So my question really is, who are those people here and other places around the world? Are they just unethical business people, or does organized crime get in at that level, at the manufacturing level?

Lieutenant STEDMAN. Our experience has been that the people that are involved in importing these goods, which is most of my business, the importation, they have been doing this for a lot of years. The community in Los Angeles has been around for probably 20 or 30 years in the garment district. My grandmother and my mother used to shop down there. These people have been importing textiles for years and years, and from the same companies that are dealing the counterfeits and the same countries.

Senator LIEBERMAN. So it is not clear whether there is organized crime involved in the manufacturing.

Lieutenant STEDMAN. That is outside my realm of expertise. I know there is once it gets here.

Senator LIEBERMAN. Dr. Levitt, do you have any information on that?

Mr. LEVITT. I don't have any information on the extent of it in this country. My sense is that it is likely, coming from production in China or elsewhere, and if there are then, as you saw in the videos, selling it here. What we do know, there is a lot more information on what goes on in South America and the likely trends may be parallel. In South America, Hezbollah operatives are deeply involved in import-export companies.

Senator LIEBERMAN. Right.

Mr. LEVITT. They are deeply imbedded in the free trade zones in Iquique and Maicao——

Senator LIEBERMAN. Where there is manufacturing going on, or is that more the export-import?

Mr. LEVITT. I don't know if there is manufacturing going on there, but they are then at that level involved in the import-export themselves as opposed to someone else importing it and them just taking and running with it here.

Senator LIEBERMAN. Got it.

Mr. LEVITT. But the software side of it is extremely inexpensive.

Senator LIEBERMAN. Inexpensive?

Mr. LEVITT. Inexpensive.

Senator LIEBERMAN. Right.

Mr. LEVITT. In our think tank, after we have an event, we put it on CD. We send it out to our trustees. We have a tower. It doesn't cost a lot of money. We do it in a couple hours. We produce a whole bunch of these CDs to send out to people who couldn't make the event.

Senator LIEBERMAN. Right. I mean, another question I raise, and I want to pursue it on my time, I want to get on to the subject, is whether legitimate businesses who happen to manufacture pocketbooks or hats are doing this as a sideline.

Mr. BUCKNER. I have had cases where there have been legitimate businesses that have also turned after hours into counterfeiting operations, double-dipping, is what we will say.

Senator LIEBERMAN. Let me ask you about the distribution chain. You said that these counterfeit goods are not only sold on street corners, etc., but often in stores. Is it your presumption that the merchants who are selling counterfeit goods know that they are counterfeit, or are they being duped?

Mr. BUCKNER. Well, I think your street corner vendors do, but your fixed retail locations, I could name names of some very big chain stores today, which I don't want to do, that have been involved in counterfeiting unknowingly.

Senator LIEBERMAN. Unknowingly?

Mr. BUCKNER. Yes, sir.

Senator LIEBERMAN. So let us now go to the subject of terrorist links. Let me ask the question simplistically. If you are in Hezbollah's cell in Los Angeles or Charlotte and you are looking to make some money to send back to finance terrorist activities, where do you go to begin to connect to the counterfeit ring? How do you do that? How would they do that?

Lieutenant STEDMAN. It is very simple. Like I said, this group down in the Santee Alley—like Kris was talking about—they have been there for years and years. The counterfeiting has been going on for years and years. You could go down there, start as just a part-time employee, and before you know it, you have people driving up to your door with vans loaded full of counterfeit stuff. You don't even have to go search it out. They are going to bring it right to you and you can start business that day.

Senator LIEBERMAN. Well, that is very interesting. So if you are Hezbollah and you are trying to raise money illegally, that is not very complicated to get into the distribution network to get the stuff.

Lieutenant STEDMAN. It is an easy business, not like the drug business, where you would have to be introduced and vetted out and be trusted before you would be able to operate. It is just so rampant that you can set up today and get started.

Senator LIEBERMAN. Let me ask this question. Is there any evidence of direct connections between organized criminal families, let us say, operations, and terrorism? In other words, I don't mean the organized criminal families are involved in terrorism, but is there any evidence of joint activities between, let us say, Hezbollah and organized criminal gangs or organized crime operations?

Mr. BUCKNER. One thing that I can say, I don't know the exact answer to that question, but groups down in Los Angeles who normally may be enemies in the real world will cooperate with the——

Senator LIEBERMAN. Such as?

Mr. BUCKNER. Let us say Israelis, Jewish folks, along with these other groups of people that we are talking about. They will cooperate to make money. They will buy from each other, trade their goods. It is all about the money.

Senator LIEBERMAN. No scruples of any kind. What I was thinking of, you know, there is some significant evidence, suggestion, that there may be cooperation between Latin American drug gangs and terrorists in limited areas, for instance, in helping to smuggle, bring terrorists into the United States. You don't have any evidence of an organized connection between those two.

We have focused on Hezbollah here. Is there any evidence of any of the other terrorist groups, Middle Eastern or otherwise, benefiting from the sale of counterfeit goods here in the United States?

Mr. LEVITT. Certainly involving criminal enterprises. I don't know the specifics about whether they are involved in counterfeit goods, but we do have evidence not only of cigarette smuggling, but of baby formula and credit card fraud——

Senator LIEBERMAN. By other terrorist groups?

Mr. LEVITT. Yes, groups like Hamas and——

Senator LAUTENBERG. I wonder, Madam Chairman, are we going to have a second round, because then I could jump in here and be out.

Senator LIEBERMAN. I am going to yield to you. I am sorry. I didn't see the clock going.

Chairman COLLINS. We will have a second round if you need additional time.

Senator LAUTENBERG. Yes, and I can get my first one and go.

Senator LIEBERMAN. OK. Very significant answers to the questions and a significant problem. I want to come back on my second round and talk a little bit more about what more we might do to focus attention and action on this problem.

Thanks, Madam Chairman.

Chairman COLLINS. Dr. Levitt, I want to give you a chance, however, to answer Senator Lieberman's question. You started to and mentioned Hamas, I believe.

Mr. LEVITT. Yes, just that we do know, and law enforcement officials tend not to speak open source in great specifics, but they have mentioned Hezbollah, Hamas, and others, is usually the way they put the package together, involved in this type of fraud activity, credit card fraud and all these other things we have discussed. I think it would be naive to assume that they are not involved in the kind of other criminal activity that we are looking at here at the table.

Chairman COLLINS. Thank you. Senator Lautenberg.

Senator LAUTENBERG. Thank you, Madam Chairman.

The thing that occurs to me is that we permit a lot of this to go on by issuing licenses to street vendors who invariably, I think, do tend to carry counterfeit or knocked-off goods, as they call it. I don't understand why the licenses are issued in the streets of New York or Boston or Newark in my State. If they don't issue the licenses to these people, which are competitive with the regular merchants, and the regular manufacturers and merchants are much more able to determine whether or not they are getting counterfeit goods. And then they just do street sweeps. I mean, to me, it is kind of cozying up to the idea and permitting discounted merchandise to be sold in front of very valuable leasehold properties that companies invest in. Do you have any idea on why these permits are issued?

Lieutenant STEDMAN. Our experience is that once the permits are issued, if there is an enforcement action, whether it is a search warrant or maybe a civil action by someone like Kris, the permit may be revoked by the city, but then the next family owner will go get a new permit with a new name and continue business on. So there is——

Senator LAUTENBERG. There ought to be a look at that.

Mr. Levitt, I want to ask you, how much damage do you think Iran does by its interference in our activities in Iraq? Are they a significant factor, do you know, in providing resources to Iraq, equipment, etc.?

Mr. LEVITT. Officials do believe that Iran is engaged in disruptive activity in Iraq for certain, not only supporting some of the militias that are causing a great deal of damage and loss of life there, but also with reportedly a great number of intelligence operatives of their own. Hezbollah's al Manar satellite television not only includes vitriolic messages of hate against Israel, but also very explicitly against the United States, and that doesn't help, either.

Senator LAUTENBERG. So we must do whatever we can to cut off resources for Iran.

Mr. LEVITT. Yes. Easier said than done, in large part because the oil industry is such that while I certainly think there is an important moral statement to be made by our not participating in funding Iran, someone else is going to step in by the nature of the fundible oil industry and I don't believe that is necessarily going to cause a loss of income to Iran unless it is extremely multi-lateral. And given the nature of international oil business and the price of oil today, there is, unfortunately, always going to be someone out there willing to buy that barrel.

Senator LAUTENBERG. I don't want to ask you to moralize here, but should American companies be particularly outside the circle—I mean, competition for the business, that as an excuse can create all kinds of things. Why don't we grow more opium here? Why don't we get into the business if someone else is going to do it? I don't buy that at all. To me, if help comes for an American company, I think it is treasonous if it goes to Iran and then helps to kill our troops. Every day, you hear the reports about two more, four more being killed, and the number of Iraqis being killed. To me, I think that we have to be—this is a very interesting hearing that we are having, Madam Chairman, and I think it is important.

I think it is important from two standpoints. One is the fleecing of the customers, the penalty for business. But when those funds flow to enemies of our country, and you mentioned, I think, Dr. Levitt, that Hezbollah has surveillance routines existing in our country——

Mr. LEVITT. That is what the FBI says, yes.

Senator LAUTENBERG. Now, are they surveying potential targets for violence against those individuals? Is that part of their scheme?

Mr. LEVITT. The FBI has described it as basically training missions for new recruits, but we need to assume, because this is traditional terrorist modus operandi, that they don't then throw out those reports. Those reports are available to be used as off-the-shelf operational menus should they decide to use them. I don't know what types of targets specifically they are surveiling, but yes, we need to be concerned that there is that possibility.

Senator LAUTENBERG. Well, everyone is very concerned with I.D. thefts. I mean, that then permits lots of funny things to go on. People hide their real identity and adopt those that would get them into places that we don't want them to be.

I thank you for your testimony, all three of you, but I really think that we have to kind of look inside and make sure that by accident or design, that no American companies are helping Iran, and I will be damned if the reason that we shouldn't do it is because a competitor could come in there. We are either out to protect democracy and lives or we are not. And if we say, well, hey, listen, business comes first, then it is a kind of society I don't think that is good for my family or my friends or my community. Thank you.

Chairman COLLINS. Mr. Buckner, you have concentrated, as has Lieutenant Stedman, on the Los Angeles area and what is going on there with regard to counterfeit goods, but is this a problem throughout the United States? Does it affect smaller cities? Could you give us some idea of the scope of counterfeiting operations in this country?

Mr. BUCKNER. Yes. The counterfeiting problem is widespread throughout the United States. Obviously, in your bigger metropolitan areas, it is more in your face, on the streets of New York, the streets of Los Angeles. But I have worked cases in probably 30 different States, and there are investigators just like me all over the country that do exactly what I do. It is amazing, the scope and the magnitude of the problem.

Chairman COLLINS. Each of you has mentioned that the high profits involved and the ease of getting into counterfeiting makes this activity very attractive to criminals, including terrorists. Is another factor that it is unlikely to be prosecuted? Is there a low risk of these cases actually making their way to the courts? Lieutenant Stedman.

Lieutenant STEDMAN. All of our cases are filed. The priority in Los Angeles is violent crime. There is a lot of violent crime going on, the robberies, rapes, and murders and all that kind of stuff. This, obviously, would take secondary interest to the District Attorneys' Offices because of that. But we have actually had pretty good cooperation from the District Attorneys' Offices. They see the problem. I think because there are units like mine out there starting to do more and more of it, they are realizing the scope of it and we are actually getting pretty good cooperation from the District Attorney's Office.

Chairman COLLINS. I think one of you may have mentioned that if you are a criminal who is dealing drugs, you have a far greater chance of going to prison than if you are selling counterfeit goods, and yet when you look at the implications of these sales for terrorist activities, you may, in fact, be doing more damage even than someone who is peddling drugs.

Mr. Buckner, could you comment based on your experience, is there a low risk of going to prison, a low risk, in fact, of being prosecuted?

Mr. BUCKNER. I have to compliment the L.A. County DA's Office. They really proactively are looking at doing more and more of these cases, but unfortunately, for example, there is a subject that we arrested five different times. On his sixth arrest, he finally is going to State prison. The sixth time, he is now going to State prison.

Unfortunately, what usually happens is guys get probation, and the problem is the profit margin is so huge on this, I don't think

anybody really realizes that it is worth the risk. If they get arrested one time, get probation, pay a fine, they look at it as a cost of doing business, and that is the unfortunate part.

At the same time, the DA's Office in L.A. County is taking these cases more seriously and filing more cases than they ever have. I think the problem is just really overwhelming.

Chairman COLLINS. Dr. Levitt, do you have any comment on that based on your work? I realize it is a little bit outside of your area.

Mr. LEVITT. Just I completely agree with what they said. We have a problem with being short-staffed, as Lieutenant Stedman said. We do need more resources. Law enforcement is doing a wonderful job, but the problems are immense and there are so many things on their plate.

As Mr. Buckner said, not only terrorists, but criminals realize how profitable this is and many of them, certainly in the case of Hezbollah, they see how successfully they have been able to engage in these activities in other places, particularly in South America, where the laws are even more lax, and they take that assumption here, too. Frankly, they find it to be very similar, probation and a fine. The way Mr. Buckner put it, the cost of doing business, I couldn't have put it better myself. That is exactly how they see it, and frankly, that is all it is.

Chairman COLLINS. That is why I think that your suggestion that we take a look at the penalties and whether there should be an enhanced penalty is a very interesting suggestion and one that I am very interested in exploring further.

Mr. LEVITT. Thank you, and I think that part of the problem is that we all agree that if there were a way to decrease demand, that would be wonderful. But, I don't know, maybe it is the realist in me. There are people with low incomes, there are people who—everybody is looking—this is the United States of America. Everybody wants to get a deal. And so it is going to be very hard, even with great public education, to significantly decrease the demand. I think that is just the reality—which doesn't mean we shouldn't try, and it doesn't mean there aren't things we can do that would make a serious dent.

But I think if we are really serious about this, we have to focus on the supply. Like Lieutenant Stedman said, we have to have the State Department and others focus on countries like China, where this is being done rampantly and being shipped here. We need to focus on vendors who may be doing this, and we need to focus on ways to decrease the supply.

Chairman COLLINS. Thank you. Just one final question for Lieutenant Stedman. You have referred to a particular part of the Los Angeles that is known for this activity. Why not just shut it down? Am I missing something here?

Lieutenant STEDMAN. There are many legitimate businesses down there, people trying to make a decent living, playing by the rules, obeying the laws. I don't know what the percentage would be, but it wouldn't be 20 or 30 percent of the area that is doing this. It is a huge draw for the city. It is huge tax revenue, legitimate tax revenue, but there is a significant counterfeit problem down there. We are doing the best we can, but I think it is—I just

don't want to shut down the whole area to get rid of a few bad apples.

Chairman COLLINS. Thank you. Senator Lieberman.

Senator LIEBERMAN. Thanks again, Madam Chairman.

You know, it strikes me, as we talk about public education, I know we hear a lot about brand name—from brand name companies involved in a lot of this stuff about cutting back on intellectual property violations around the world, particularly in Asia, but around the world. Maybe I missed it, but—and American companies lose hundreds of—well, I may be overstating it, but a lot of billions of dollars, hundreds of billions, in this operation.

I wonder if it would be worth it for them to launch an advertising campaign which basically says to people, when you buy something—when you buy a counterfeit good on the street, you may be saving a few bucks, but the dollars you are spending may well be going to terrorist groups that are going to use it to kill Americans. That is a strong message, but from all you have told us today, there is some truth to it. I don't know, it is not within your—maybe the Chairman and I can think about how to call on some of the large companies that are really concerned about this problem and suffer from it to try the demand reduction part of it.

Mostly up until now, as I understand it, they have tried the supply reduction, particularly in trade negotiations and diplomatic relations with some of the producer countries, and it obviously hasn't worked very well.

Mr. BUCKNER. One thing I can say about several of the brand owners, they have partnered up with several different magazines and they have put into print and sponsored articles regarding counterfeiting and where the proceeds go and the other implications. And more and more, since I started this business, more and more, I am seeing these companies do press releases and actually interact with the press, where they were scared to interact with the press before, to try to get the message out. But I definitely agree that more needs to be done on behalf of the private sector.

Mr. LEVITT. If I could add——

Senator LIEBERMAN. Yes.

Mr. LEVITT [continuing]. One concern, and that is, again, I think targeting demand is important, but you may recall that there were commercials years ago, post-September 11, about drugs and how purchasing drugs is not only an issue of drugs, it also can finance terrorism.

Senator LIEBERMAN. Yes.

Mr. LEVITT. They were so poorly received by the public and it became a joke, which is the last thing we would want to do. So I am not a marketing expert, but my concern would be that it has to be done, it has to be done properly. I am not sure what the right exact message is——

Senator LIEBERMAN. Because the public thought it was far-fetched?

Mr. LEVITT. Yes.

Senator LIEBERMAN. OK. That is something that the marketing and advertising experts at the brand name companies can answer better than I can.

Lieutenant Stedman, Senator Collins asked a question which raised an interesting point about this problem obviously doesn't only exist in Los Angeles. It exists, I presume, anywhere there is a significant market for counterfeit goods, and that is a lot of places in the United States of America. What is your sense—a quick response, but what is your sense of to what extent others, particularly large urban police departments, or sheriff's offices, have focused efforts on stopping counterfeit sales?

Lieutenant STEDMAN. I know New York had a huge problem. I know they are trying to put a dent in it like we are.

Senator LIEBERMAN. NYPD is on it.

Lieutenant STEDMAN. That is correct. I was in New York over last summer and it was pretty rampant. I mean, my daughter tried to buy a purse and I dissuaded her, but——

Senator LIEBERMAN. Good work. [Laughter.]

Lieutenant STEDMAN. Yes. It was worse than even Los Angeles. It was everywhere, everywhere I walked down the street. But I know in New York, we talk to them often——

Senator LIEBERMAN. That is what I was just going to ask. Do you all communicate on this problem?

Lieutenant STEDMAN. We do. We have connections in most of the major metropolitan areas and we talk about people of interest, and we run across a lot of business records where different businesses are talking to each other, shipping back and forth. There is actually an overland trucking of this material from New York to California in some instances, or by train. So it doesn't just come through the ports of Los Angeles and Long Beach. It comes overland, probably stops along the way. But between New York and Los Angeles, there is a huge transit.

Senator LIEBERMAN. This is obviously a national problem. It is an international problem. So let me ask you now, to what extent in the work that you are doing in Los Angeles you have received cooperation from Federal agencies.

Lieutenant STEDMAN. We receive actually outstanding cooperation from the Customs Service and from——

Senator LIEBERMAN. And this obviously has to do with——

Lieutenant STEDMAN. The ports.

Senator LIEBERMAN [continuing]. The counterfeit goods coming in.

Lieutenant STEDMAN. Yes. They do a great job down there, but I am sure you have been to the port. You know how many containers come in every day. It is really shoveling sand against the tide. We do get great cooperation when we try and backtrack some of the shipments that come in from Customs. We have a great relationship with ICE agents. A lot of these people's immigration status is iffy.

Senator LIEBERMAN. Right.

Lieutenant STEDMAN. And we invite them along with us when we think that might be the case.

Senator LIEBERMAN. So Customs and Immigration, good cooperation. How about Federal law enforcement, like FBI?

Lieutenant STEDMAN. We speak to the FBI often. We deconflict every case that we do, because we never know where we are going or who we are going to be seeing that day. So we have five——

Senator LIEBERMAN. What does deconflict mean in this case, for the record?

Lieutenant STEDMAN. Deconfliction means that we are not stepping on somebody else's toes.

Senator LIEBERMAN. Another agency that is investigating, you mean?

Lieutenant STEDMAN. That is correct. We have five members of the Sheriff's Department on the JTTF. We clear every investigation through them to make sure we are not stepping in the middle of an investigation that is already going on at the Federal level.

Senator LIEBERMAN. So that, in other words, you may be pursuing a counterfeit goods ring, but somebody else will be pursuing those same people for a terrorist investigation?

Lieutenant STEDMAN. Exactly right. I don't get that information, but I make that attempt to make sure we don't bungle somebody else's investigation by either hitting the suspect too quick or not at all, so we do that on every case that we do.

Senator LIEBERMAN. Dr. Levitt, with your experience at the FBI, can you comment on whether you think the efforts to enforce anti-counterfeiting laws are getting enough attention and are sufficiently coordinated at the Federal level, particularly whether there is a clear sense of coordination between the FBI, Treasury, for instance?

Mr. LEVITT. Well, unfortunately, I really can't, only because I wasn't involved in any of that at the FBI. I was on the counterterrorism and on the intelligence side——

Senator LIEBERMAN. Right.

Mr. LEVITT [continuing]. And that would have primarily been run through the Criminal Division. But I do know from my interaction with FBI officials and Treasury officials now that there is a tremendous amount of attention being given not only to this issue substantively, but to the nature of the cooperation. I think there is still some ways to go, but I am actually very pleased at the kind of attention that people at very senior levels are giving to making sure that the interconnectivity and the cooperation is improving.

Senator LIEBERMAN. That is encouraging.

One last question. I am curious, a couple of times Paraguay has been mentioned. What is going on in Paraguay?

Mr. LEVITT. Paraguay, Brazil, and Argentina, where those three countries meet is the triple border, or the tri-border area. Asuncion is a very big problem, and you can cross that border with great ease. It is beautiful. A very famous waterfall is there.

Senator LIEBERMAN. Right.

Mr. LEVITT. A great tourist attraction. And if there is ever any counterfeit good that you could ever imagine, it is there, and——

Senator LIEBERMAN. Manufacturing is going on there, or——

Mr. LEVITT. I don't know that there is manufacturing going on there.

Senator LIEBERMAN [continuing]. Or sales?

Mr. LEVITT. My sense is that it is all sales and that it is—basically, imagine this neighborhood in Los Angeles times I don't know how many——

Senator LIEBERMAN. So what you are saying is that there is reason to believe that there is at least a Hezbollah presence there——

Mr. LEVITT. We know there is a Hezbollah presence there. There is a Hamas presence there. It is a very serious problem. It is getting a lot of attention.

Senator LIEBERMAN. Thank you. Thank you, all three of you. You have really been excellent, and I hope we can take it from here.

Thanks, Madam Chairman.

Chairman COLLINS. Thank you, Senator.

I want to thank our witnesses today for their fascinating and well-informed testimony. It was very helpful.

We have had success in this country in shutting down some of the formal mechanisms, the financial mechanisms that terrorist groups have been using as well as closing down certain Islamic charities that have been used as conduits for terrorists to finance their operations. But as today's hearing shows, each time one avenue is closed down, another one is exploited by ever-resourceful terrorist groups, and counterfeiting, because it is extremely lucrative and easy to get into, is the mechanism that terrorist groups have discovered and are exploiting.

I want to thank you for increasing our knowledge of this, and I hope this hearing will help promote better public awareness, as well, which I agree with Mr. Buckner is a key part of the solution in addition to looking at enhanced penalties, international efforts, and other means of cracking down on this problem.

I want to thank the staff for their hard work on this hearing, and I particularly want to recognize the efforts of Bill Priestap, who is sitting quietly in the corner. He has worked for the Committee for the past 16 months as a detailee from the FBI. He was the one who suggested that we look into this area. He has worked very hard on a whole host of issues, but particularly the terrorism financing issues, and his work has been outstanding.

I am very sad to have him go back to the FBI, but I do appreciate the Director allowing us to have him for more than a year's time and we very much appreciate the new role that he is going to be taking on at the Bureau in the new Intelligence Office. I would note, he starts his new job next week, so he is not even taking any time off between assignments.

So, Bill, thank you for all your hard work, and we wish you well and will miss working with you.

The hearing record will remain open for 15 days.

I do want to announce that the Committee will be having a very brief business meeting after the first vote to act on some pending nominations, including that of Phil Perry, who has been nominated to be the General Counsel of the Department of Homeland Security.

This hearing is now adjourned.

[Whereupon, at 11:14 a.m., the Committee was adjourned.]

# APPENDIX

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**United States Senate**
**Committee on Homeland Security and Governmental Affairs**

**Testimony of John C. Stedman , Lieutenant**
**County of Los Angeles Sheriff's Department**
**Leroy D. Baca, Sheriff**
**May 25, 2005**

**"Counterfeit Goods: Easy Cash for Criminals and Terrorists"**

My testimony today will address the enforcement efforts of the Los Angeles County Sheriff's Department regarding Intellectual Property Right (IPR) crimes and the involvement of organized crime groups operating in Los Angeles County.

My experience with IPR crimes dates to the late 1980's when my unit was approached by members of the Latin American Music Association. They were experiencing large revenue losses due to the proliferation of unauthorized and illegal duplication of music onto cassette tapes. The Music Association was seeking cooperation from local law enforcement to enforce a State of California statute that makes it a crime to illegally duplicate copyrighted or trademarked materials. Over the next two years, my unit investigated dozens of these cases resulting in the seizure of hundreds of thousands of cassette tapes and incarceration of many suspects.

With the advent of the video-cassette rental business during the same time period, we began to see the illegal duplication of motion pictures as a high-return, low risk, criminal enterprise. During the 1990's, The Motion Picture Association of America (MPAA) also requested the services of local law enforcement to enforce the same copyright or trademark statutes of California. Detectives under my supervision completed many of these investigations seizing thousands of illegally duplicated motion pictures. Many of these videos were of films not yet released to the theaters.

In 2003, I was assigned to supervise the Criminal Investigation Section of the Emergency Operations Bureau. It was at this time that I gained a full realization of the pervasiveness of IPR crimes in Los Angeles County. We concentrated our investigative resources on IPR crimes and have uncovered significant organized criminal enterprises operating within Los Angeles County. Victims of these organized criminal groups include the tobacco industry, luxury goods manufacturers, clothing companies, and the music and motion picture industries. Information in open sources indicates that across the globe anything that has a decent profit margin is being counterfeited. Items such as motorcycles, auto parts, memory chips, software, consumer electronics, and of most concern, pharmaceuticals, are being manufactured.

While there are no local statistics on the magnitude of the problem, I can relate what my small team of one sergeant and six investigators has accomplished in little more than one year. We have served 60 search warrants which have yielded 125 arrests and 16 million dollars in seized counterfeit products. An additional 3.5 million dollars in cash has been seized and is currently in forfeiture proceedings.

Within the Sheriff's Department there are units designated to combat organized criminal enterprises and we are represented on nearly every task force created to investigate these groups. These units have similar experiences with IPR investigations, noting that the profits are enormous with minimal criminal exposure. Russian Organized Crime, Eurasian Organized Crime, Asian Organized Crime and Lebanese Organized Crime groups all profit from IPR crimes. Additionally, we believe that there may be a trend developing for local gang involvement in IPR criminal activity. Recently, we have investigated several individuals who have strong gang ties and extensive criminal records. During interviews, these suspects have admitted that IPR crime is attractive because of the high profit and minimal jail sentences. In the parlance of one suspect, "It's better than the dope business, no ones going to prison for DVDs."

There are also indicators that some associates of terrorist groups may be involved in IPR crime. During the course of our investigations, we have encountered suspects who have shown great affinity for Hezbollah and its leadership. The following are just two examples: during the search of a residence pursuant to an IPR related search warrant, I saw small Hezbollah flags displayed in the suspect's bedroom. Next to the flags was a photograph of Hassan Nasrallah whom I recognized as the leader of Hezbollah. The suspect's wife asked me if I knew the subject of the photograph. I identified Nasrallah and the wife said, "We love him because he protects us from the Jews". Also in the home were dozens of audio tapes of Nasrallah's speeches. During the search, one of my detectives also found a locket which contained a picture of the male suspect on one side and Sheik Nasrallah on the other.

In 2004, detectives served an IPR search warrant at a clothing store in Los Angeles County. During the course of the search, thousands of dollars in counterfeit clothing was recovered as were two unregistered firearms. During the booking process, the suspect was found to have a tattoo of the Hezbollah flag on his arm.

Also in 2004, detectives served a multi-location IPR related search warrant. During the course of the investigation, detectives located a photo album. Within the photo album were dozens of pictures of attendees at a fund raising event for the Holy Land Foundation. When questioned about the album, the suspect said that the Holy Land Foundation was not a terrorist funding operation. When I informed the suspect that the United States government had shut down the charity because of its alleged support of Hamas, the suspect replied that the United States government was stupid and would do anything the Jews told them.

When confronted with these indicators, we pass the information immediately to the Los Angeles Joint Terrorism Task Force (JTTF) for further review. As a result of this kind of information sharing, we enjoy an outstanding relationship with the JTTF as well as with the other three FBI offices located in Los Angeles County.

As I have stated, the financial rewards of IPR crimes are immense. Many times the biggest issue for the criminal or his group is how to disperse the money generated from the crimes committed. It is difficult to use traditional banking practices to account for the huge profits generated. In one of our cases, we discovered over $800,000 in cash located throughout the

suspect's residence, hidden in trash bags under beds, stuffed in trash cans, and stashed in the attic. In fact, more than $10,000 was found in a child's piggy bank. On other occasions, we have seen activity consistent with money laundering and structuring occurring between similar businesses.

Another of our cases began with the stop of a suspect at LAX by U.S. Customs Officers. Strapped to the suspect's body was more than $230,000 in cash. The suspect told the Customs Officers that she was enroute to Lebanon for "vacation." Information was developed that the suspect owned a chain of cigarette shops. Service of search warrants led to the seizure of more than 1,000 cartons of counterfeit cigarettes, an additional $70,000 in cash as well as wire transfers to banks throughout the world.

The financial cost of IPR related crimes to the State of California is significant. As an example my small team has seized about 40,000 cartons of counterfeit, untaxed, cigarettes. The California State Tax on cigarettes is eight dollars and seventy cents per carton, representing a loss to the State of $348,000. It should not be a surprise to anyone that suspects involved in IPR crime do not concern themselves with paying appropriate taxes whether federal, state or local. Our experience has been that suspects claiming twenty or thirty thousand dollars on their income tax forms routinely keep tens of thousands of dollars in cash at their homes.

The World Customs Organization estimates counterfeiting accounts for lost sales to legitimate companies worldwide at over 500 billion dollars. The United States accounts for nearly $300 billion of this total. Official estimates are that between five and seven percent of products produced worldwide are counterfeit. Despite these numbers, large, multi-national corporations, big tobacco, and the pharmaceutical industry are not generally seen as sympathetic victims; retail purchasers seek out these goods with little appreciation for the ramifications of such a purchase. There must be the understanding that this crime affects all citizens through fraud, the diversion of tax revenue, and the empowerment of the criminal element.

The Los Angeles County Sheriff's Department has, like most local agencies, suffered cutbacks in personnel over the past several years due to severe budget curtailments. There has not been a mechanism to address IPR crimes other than that based on interest from small units or individual investigators. We believe there is a critical void in personnel to mount an effective campaign against the criminal enterprises that utilize IPR as a revenue stream. It is well documented that organized criminal enterprises engage in IPR crimes. There are mounting indicators of the involvement of terrorist groups and their supporters.

In Los Angeles County we believe there should be task force commitment in order to combat this problem. Members of the Sheriff's Department have begun to explore different sources of revenue to fund such a task force in our region. The private sector has shown interest in contributing to such an effort. In fact, the private sector, comprised of manufacturers and companies such as Investigative Consultants, whose president, Kris Buckner, is speaking today, plays a vital role in our enforcement efforts. Without this cooperative public/private sector relationship, the Sheriff's Department, because of limited personnel resources, would quickly be overwhelmed and would not be able to maintain our investigative pace.

We also believe there should be legislation to enact or increase the levy on containers shipped through the Ports of Los Angeles and Long Beach. These levies would fund intensified IPR enforcement efforts. It is my hope that by drawing more attention to this crime, we can reinforce the American dream of having an idea, bringing it to market, and profiting from its success without interference from the criminal element.

On behalf of Los Angeles County Sheriff Leroy D. Baca, I wish to thank the Committee for this opportunity to represent our County in discussing this important topic.

# Statement of Kris Buckner
# President, Investigative Consultants
# Before the U.S. Senate
# Homeland Security and Governmental Affairs Committee
# 25 MAY 2005

**"Counterfeit Goods: Easy Cash for Criminals and Terrorists"**

I would like to thank Chairman Collins, Senator Lieberman, and all other Members of the committee for the opportunity to appear before you today. Intellectual property crime is an important topic, and I am very pleased that the committee is holding this hearing to discuss how intellectual property crime affects our country, including the possibility that proceeds from counterfeiting fund terrorism.

For the record, my name is Kris Buckner. I am the President of Investigative Consultants, a licensed private investigation firm based in Southern California. I have been a private investigator for over ten years, and specialize in investigations involving the manufacture, distribution, and sale of counterfeit goods.

Investigative Consultants began as a single person operation in 1994. The company now employs fourteen full-time employees and several part-time and contract employees. Ninety-five percent of the company's time is spent investigating intellectual property matters, and we currently represent over eighty different brand owners.

The company plays a vital role in the fight against counterfeiting and piracy on behalf of the world famous brand owners we represent. We are the front line for identifying and investigating the counterfeiters and pirates who victimize brand owners. Our efforts include investigating all types of criminal counterfeiters, from small time street vendors to large, highly organized manufacturers, importers, smugglers, and sellers of counterfeit and pirated merchandise.

The job of our company is to work on behalf of brand owners to uncover evidence of counterfeiting activities. When we find concrete evidence that some person or group is substantially engaged in the counterfeit goods market, we contact the appropriate law enforcement agency and provide them with the evidence. If, in the course of their investigation, law enforcement seizes the counterfeit goods, our company assists them, on behalf of the brand owner, in the identification, inventory, and storage of the counterfeit items. In sum, we represent victim companies and assist law enforcement to ensure that counterfeiters are brought to justice.

**The Scope of the Problem**

How big is the problem of counterfeit goods? Let me answer that question in three words - "out of control." In only ten years, my company has conducted over 9,000 intellectual property investigations that have resulted in the recovery and seizure of over one billion dollars worth of counterfeit and pirated merchandise. Over the past ten years, our investigations helped law enforcement arrest over 3,000 people for counterfeiting and piracy. Last year, in California alone, our investigations helped law enforcement arrest over 600 people for movie piracy. There is no end in sight - my business continues to grow.

The counterfeiting problem is not just limited to handbags, watches, and other luxury goods. I have been involved in cases involving DVD movies, music CDs, glue, children's toys, sunglasses, food items, computer equipment, toner products, and numerous other items. I have also seen cases where brake pads, aircraft parts, baby formula, and even cough syrup have been counterfeited. You name it, and criminals can and will counterfeit it. As long as counterfeiters are making money, they do not care who they hurt or kill.

Most brand owners go to great lengths to combat the problem. One of the ways in which they do this is to hire people like me to serve cease-and-desist notices on people we know to be engaging in the sale of counterfeit merchandise. In my hand is what I call our "subject book." This is just one of five such binders, all of which are as big or bigger than this, that are kept in my office. These binders contain photographs of vendors that my company has served with cease-and-desist notices. As you can see, the binder contains a massive amount of photographs. Ninety percent of these vendors continued to sell counterfeit merchandise - even after we advised them that what they were doing was illegal. They continue their operations because of the large amount of money they make. And make no mistake about it, counterfeiting is profitable. I have participated in multiple law enforcement operations in which huge sums of cash have been recovered. During one such raid, officers found over $370,000 in a decrepit warehouse. That money was just some of the profits enjoyed by a subject who had merely been selling counterfeit blankets.

Counterfeiting is out of control, and I believe the problem will continue to grow until the public realizes that counterfeiting is not a victimless crime, and until the laws which penalize counterfeiters are strengthened. Keep in mind that counterfeiting is just as, if not more, lucrative than selling drugs. A counterfeiter can sell counterfeit handbags and make as much money as someone selling cocaine. However, today, there is little chance that a counterfeiter will ever see the inside of a prison. We need to do a better job protecting the intellectual ingenuity that has made our country so great. We can no longer allow criminals to so easily profit from the sale of counterfeits.

**How a Counterfeit Goods Operation Works**

Some counterfeit goods are manufactured in the U.S. While assisting law enforcement, I have seen California factories involved in the large-scale manufacture of counterfeit merchandise. I have been involved in cases in which the owners of factories routinely locked employees inside the manufacturing facilities. Law enforcement had to call the fire department, which used the "jaws-of-life" to cut open the doors and free the employees. If there had been a fire, the employees would have died. Counterfeiters value cash more than human life.

The vast majority of counterfeit merchandise is manufactured outside of the United States, in countries like China, South Korea, Taiwan and Mexico. The merchandise is often manufactured under unsafe conditions, and there have been cases where the counterfeiters used child labor to make the products.

After counterfeit goods are manufactured overseas, the merchandise is loaded into containers and exported to the United States. Counterfeiters will often pack the counterfeit merchandise in the rear of the container and pack authentic merchandise at the front of the container. Thus, customs inspectors would have to unload the entire container to find the counterfeit merchandise. Once the counterfeit merchandise passes customs, it is taken to warehouses for distribution. The distributors then sell the merchandise to various sized wholesalers and retailers, who, in-turn, sell it to consumers.

Counterfeiters often smuggle goods into the U.S. Several times, I have come across brand-name counterfeit handbags sewn inside the linings of generic handbags. Once the generic handbags pass customs, counterfeiters cut open the generic handbags and remove the counterfeit ones. It may seem like a lot of work just to smuggle counterfeit handbags, but keep in mind that a counterfeiter can make approximately $500,000, in cash, per container.

It is wrong to think that counterfeit merchandise is only sold on street corners. Counterfeit merchandise regularly ends up in all types of stores, including large chain department stores, hotel gift shops, upscale boutiques, swap meets, flea markets, and other retail locations. There is a shopping district in Los Angeles called Santee Alley where counterfeit merchandise is openly sold. On any given day there are over 75 vendors in Santee Alley selling all kinds of counterfeit merchandise.

**Do Organized Criminal Groups Engage in the Sale of Counterfeit Goods?**

I am frequently asked whether I believe organized criminal groups engage in the sale of counterfeit and pirated merchandise, and my answer is, "yes." Sometimes an organized counterfeiting operation profits primarily from the sale

of counterfeit goods, whereas in other instances, counterfeiting is just another revenue stream for the crime syndicate.

Sophisticated counterfeiting operations often mirror other sophisticated criminal and terrorist operations. Counterfeiting operations are divided into operating cells, often according to their manufacturing, distributing, or selling functions. By operating in cells, counterfeiters lessen the possibility that their entire operation can be taken-down by law enforcement.

In Los Angeles, the various criminal groups profiting from the sale of counterfeit goods are extremely well organized. They hire look-outs and utilize counter-surveillance techniques to track my employees' activities and the activities of law enforcement. The groups use two-way radios, and have also developed elaborate warning systems to alert vendors to impending enforcement actions. During heavy enforcement periods, counterfeiters have placed look-outs near the Los Angeles Police Department's Central Division to monitor the movements of law enforcement. Counterfeiters have surveilled my team of investigators. They have also been spotted surveilling our office location. During counterfeit good raids, I have found lists containing the names of my employees, their physical descriptions, and descriptions of company vehicles, including license plate numbers.

Because we often act as expert witnesses for the prosecution in counterfeit good cases, counterfeiters have hired private investigators to try to discredit me and my team of investigators. Counterfeiters are making so much money that they will do anything to disrupt our efforts. My investigators have been assaulted by counterfeiters. Counterfeiters have slashed the tires of our vehicles. A counterfeiter injured one of my investigators when he broke out the window of the investigator's vehicle - while the investigator was driving it.

Many groups engaging in the sale of counterfeit goods also sell drugs.
We have worked on cases in which counterfeiters were selling powder cocaine, crack cocaine, and marijuana. One individual, who was awaiting trial on a counterfeit goods charge, was arrested by Immigration and Customs Enforcement agents for smuggling drugs from the Middle-East into the U.S. We have also come across counterfeiters in possession of loaded firearms.

There is clear and convincing evidence that street gangs have begun to profit from the sale of counterfeit merchandise on the streets of Los Angeles. Not only do the gangs place their "soldiers" on the street to sell pirated movies and music, they "tax" other street vendors who want to sell counterfeit merchandise on their turf. It only stands to reason then that proceeds from the sale of counterfeit goods are used to buy drugs and guns.

More and more organized criminal groups are engaging in the sale of counterfeit merchandise to raise money. The great profits and the limited risk of prosecution

make it an extremely attractive enterprise. For these criminals, it is simply a matter of business: if they get caught selling drugs, they go to prison, whereas if they get caught selling counterfeit goods, they get probation.

**Do Terrorists Engage in the Sale of Counterfeit Goods?**

I am also frequently asked if terrorist groups profit from the sale of counterfeit goods. I do not know the answer to that question. What I do know is that while working with law enforcement to conduct counterfeit good raids, I have been in homes and businesses in which photos of Hezbollah leader Sheik Nasrallah have been prominently displayed. On several occasions during these same raids, I have heard subjects make anti-Israeli and anti-Jewish statements. I have also observed evidence indicating that counterfeiters send large amounts of money to places such as Lebanon and Paraguay.

**Is the Sale of Counterfeit Goods a Victimless Crime?**

My company is hired by major corporations, and I know that many people don't have any sympathy for "big businesses." However, the public needs to understand that they are forced to pay higher prices for brand name products because of counterfeiters. It has been estimated that counterfeiting costs brand owners billions of dollars a year in lost revenue. Brand owners must raise their prices to recoup these losses.

In my opinion, the general public has no appreciation for how many "Mom and Pop" retail establishments are driven out of business every year by counterfeiters. As everyone knows, there is great demand for brand name products. How can a legitimate small retailer compete when consumers have the option of buying a $20.00 pair of generic sunglasses in their store or a $20.00 pair of brand name counterfeit sunglasses in the store next door. Far too many consumers buy the counterfeit brand name sunglasses.

Time and again I receive calls from legitimate small business owners begging me to investigate their "counterfeit competitors." These people know that they will be quickly driven out of business, if the seller of counterfeit goods is allowed to continue to operate next door to them. There is nothing more rewarding than receiving a congratulatory phone call from these same small business owners, after participating in a counterfeit goods raid with law enforcement.

The public also needs to understand that millions of dollars in tax revenue is lost every year to counterfeiters. Counterfeit good sales are primarily conducted in cash, and sellers of counterfeit goods don't pay governments the sales taxes that are supposed to be generated from the sales of products. With budgets tight, especially in California, the economic cost of the lost tax revenue is staggering.

In closing, I would just like to say that I am not an expert on organized crime and I am not an expert on terrorism. But, I do know how counterfeit good operations work - I live and breath counterfeit goods. And every day, in the course of my investigations, I see many things that concern me. It only takes common sense to believe that proceeds from counterfeiting benefit terrorist groups. The opportunity is there and the indicators are there. The sale of counterfeit goods is not a victimless crime.

I again want to thank the committee for holding this hearing, and I would like to acknowledge the outstanding efforts of the law enforcement agencies in California, especially the Criminal Investigative Section of the Los Angeles County Sheriff's Department and the Los Angeles Police Department. They understand the importance of aggressively pursuing counterfeiters.

Thank you.

# Hezbollah: Financing Terror Through Criminal Enterprise[1]

Testimony of
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Committee on Homeland Security and Governmental Affairs
United States Senate

## I. INTRODUCTION: CONSTRICTING THE OPERATING ENVIRONMENT

It is a painful reality that no counterterrorism technique or effort, however extensive, international, or comprehensive, will put an end to terror attacks or uproot terrorism. There will always be people and groups with entrenched causes, an overwhelming sense of frustration, a self-justifying worldview, and a healthy dose of evil, who will resort to violence as a means of expression.

The goal of counterterrorism, therefore, should be to constrict the environment in which terrorists operate so that it is increasingly difficult for terrorists to carry out their plots of destruction and death at every level, such as conducting operations, procuring and transferring false documents, ferrying fugitives from one place to another, and financing, laundering, and transferring funds. This includes cracking down not only on operational cells, but on their logistical and financial support networks as well.

The September 11 attacks drove home the central role logistical and financial support networks play in international terrorist operations. Clearly, individuals who provide such support must be recognized as terrorists of the same caliber as those who use that support to execute attacks.

Since September 2001, America—together with many of its allies—has spearheaded a groundbreaking and comprehensive disruption operation to stem the flow of funds to and among terrorist groups. Combined with the unprecedented law enforcement and intelligence efforts to apprehend terrorist operatives worldwide and thereby constrict the space in which terrorists can operate, cracking down on terrorist financing denies them the means to travel, communicate, procure equipment, and conduct attacks. Though the amount of money frozen internationally remains negligible, the impact of freezing terrorists' assets can be significant if the right accounts, companies, or front organizations are shut down. Denying terrorists access to their preferred means of raising, laundering, and transferring funds complicates their efforts to conduct their activities.

## II. BEYOND AL-QAEDA: THE THREAT FROM HEZBOLLAH

However, al-Qaeda is not the only international terrorist network that poses a serious threat. Deputy Secretary of State Richard Armitage identified Hezbollah as "the A team of terrorism," and warned "their time will come, there's no question about it."[3] Semantics aside, such statements are more than just tough talk. Highlights of Hezbollah's record of terror attacks include suicide truck bombings targeting U.S. and French forces in Beirut (in 1983 and 1984) and U.S. forces again in Saudi Arabia (in 1996), its record of suicide bombing attacks targeting Jewish and Israeli interests such as those in Argentina (1992 and 1994) and in Thailand (attempted in 1994), and a host of other plots targeting American, French, German, British, Kuwaiti, Bahraini and other interests in plots from Europe to Southeast Asia to the Middle East.[4]

According to U.S. authorities, concern over the threat posed by Hezbollah is well placed. FBI officials testified in February 2002 that "FBI investigations to date continue to indicate that many Hezbollah subjects based in the United States have the capability to attempt terrorist attacks here should this be a desired objective of the group."[5] Similarly, CIA Director George Tenet testified

in February 2003 that "Hezbollah, as an organization with capability and worldwide presence, is [al-Qaeda's] equal, if not a far more capable organization."[6]

Still, some maintain that Hezbollah is merely a "resistance" organization responding to Israeli occupation of disputed land. The distinction is, appropriately, lost on most Western experts, given that the "resistance" groups in question employ acts of terrorism such as suicide bombings to achieve their goals and that many of the operatives go back and forth between serving in guerilla units fighting in South Lebanon and international terror cells plotting bombings abroad.[7] In any event, no goal, however legitimate, legitimizes the use of terrorist tactics and the killing of innocent civilians.

U.S. intelligence officials have also expressed concern over possible links between Hezbollah and Abu Musab al-Zarqawi, highlighting the ad hoc tactical relationship brewing between Iran's Shia proxy and the loosely affiliated al-Qaeda network. In September 2003, when U.S. authorities designated Zarqawi and several of his associates as 'Specially Designated Global Terrorist' entities, the Treasury said that Zarqawi not only had "ties" to Hezbollah, but that plans were in place for his deputies to meet with both Hezbollah and Asbat al-Ansar (a Lebanese Sunni terrorist group), "and any other group that would enable them to smuggle mujaheddin [sic] into Palestine."[8] The Treasury claimed that Zarqawi received "more than $35,000" in mid 2001 "for work in Palestine," which included "finding a mechanism that would enable more suicide martyrs to enter Israel" as well as "to provide training on explosives, poisons, and remote controlled devices."[9]

Similarly, while the 9/11 Commission found no evidence that Iran or Hezbollah had advance knowledge of the September 11 plot, the commission's report does note that Iran and Hezbollah provided assistance to al-Qaeda on several occasions. For example, al-Qaeda operatives were allowed to travel through Iran with great ease. Entry stamps were not put in Saudi operatives' passports at the border, though at least eight of the September 11 hijackers transited the country between October 2000 and February 2001. The report also noted a "persistence of contacts between Iranian security officials and senior al-Qaeda figures" and drew attention to an informal agreement by which Iran would support al-Qaeda training with the understanding that such training would be used "for actions carried out primarily against Israel and the United States." Indeed, al-Qaeda operatives were trained in explosives, security, and intelligence on at least two occasions, with one group trained in Iran around 1992, and a second trained by Hezbollah in Lebanon's Beka'a Valley in the fall of 1993.[10]

In the final analysis, whether suspected ties between Hezbollah and global jihadist elements such as Zarqawi and the 9/11 plotters are proved or not, Hezbollah warrants being designated a terrorist group of global reach on the merits of its own activities. The means by which the group finances its vast and varied activities is therefore of paramount concern to U.S. intelligence officials and policymakers.

HEZBOLLAH FINANCES: A SNAPSHOT

Few details are publicly available about Hezbollah's finances. Iran, however, is believed to fund Hezbollah to the tune of at least $100 million per year. Recently, Western diplomats and

analysts in Lebanon estimated Hezbollah may now receive closer to $200 million a year from Iran.[11]

A few snippets of information are publicly available, providing some measure of insight into the organization's funding activities. Consider the following examples:

- ✓ In the wake of the death of Palestinian leader Yasser Arafat, Hezbollah reportedly received an additional $22 million from Iranian intelligence to support Palestinian terrorist groups and foment instability in Israel, the West Bank and Gaza.[12]

- ✓ Iran was also reported to have financed and established terrorist training camps in the Syrian-controlled Beka'a Valley to train Hezbollah, Hamas, PIJ and PFLP-GC terrorists to use rockets such as the short range Fajr-5 missile and the SA-7 anti-aircraft rocket.[13] According to a report by a "Western intelligence agency," the Iranian training program cost $50 million and included training Lebanese and Palestinian terrorists to carry out "underwater suicide operations."[14]

- ✓ At the time of the founding of Hezbollah's al-Manar satellite television in 1991, the station reportedly received seed money from Iran and had a running budget of $1 million. By 2002 its annual budget had grown to approximately $15 million.[15] Middle East analysts and journalists maintain that most of this funding comes from Iran.[16]

- ✓ According to Arab media reports, in December 2003 Hezbollah lost US$2 million when an aircraft crashed in Africa carrying contributions from wealthy Lebanese expatriates living in Africa.[17]

- ✓ In 2001, Paraguayan police searched the home of Hezbollah operative Sobhi Mahmoud Fayad in Ciudad Del Este, a town along the tri-border area where the borders of Brazil, Argentina, and Paraguay meet. Searching Fayad's home, police found receipts from the Martyr's Organization for donations Fayad sent totaling more than $3.5 million dollars.[18] Authorities believe Fayad sent over $50 million to Hezbollah since 1995.

- ✓ In some cases, the foreign remittances discussed above are funneled to Hezbollah though the group's charities. Members of the Hezbollah cell in Charlotte, North Carolina, received receipts from Hezbollah for their donations, including receipts from the office of then-Hezbollah spiritual leader Sheikh Mohammad Fadlallah.[19]

- ✓ Law enforcement authorities were able to trace half a million dollars through various accounts tied to members of the Charlotte cell, but they believe most of the funds – estimated overall at about $2 million stayed in cash. Of this, tens of thousands of dollars – some officials estimate it may be closer to a few hundred thousand of dollars – were never found.

- ✓ One receipt, signed by Ali Abu Al Shaer, the financial manager of "the office of his Excellency Ayat Allah Mr. Mohammed Hussein Fadlallah," thanked "brother

Mohammed Hammoud," the subsequently convicted leader of the Charlotte cell, for a $1,300 donation.[20]

- ✓ Hezbollah runs the al-Janoub hospital in the southern Lebanese city of Nabatiyah—one out of a network of some fifty hospitals the group runs throughout the country. The hospital receives $100,000 a month from Hezbollah and is run by Ahmad Saad, the hospital director who is also a member of Hezbollah's "national health committee."[21]

- ✓ Paraguayan officials arrested Ali Khalil Mehri for selling millions of dollars in pirated software and funding Hezbollah with some of the profits.[22]

- ✓ The tri-border area is especially important to Hezbollah, where the group raises close to $10,000,000 a year, according to a study produced by the U.S. Naval War College. According to the report, "U.S. Southern Command estimates that Islamist terrorist groups raise between three hundred million and five hundred million dollars per year in the Triple Frontier and the duty-free zones of Iquique, Colon, Maicao, and Margarita Island."[23]

- ✓ Hezbollah uses money wiring companies like Western Union not only to launder and transfer funds, but to raise money as well. For example, Hezbollah funding to Palestinian terrorist groups in the West Bank is almost entirely transferred via Western Union – including some $3 million over a one year period in 2003-2004 alone. In some cases, Hezbollah activists run Western Union offices and share the profits with Hezbollah.[24]

What is clear is that above and beyond the significant funding the group receives from Iran, Hezbollah raises still more funds – especially through foreign expatriate remittances, charities and front organizations, and criminal enterprises.

FOREIGN EXPATRIATE REMITTANCES

Hezbollah receives significant financial support from the contributions of Hezbollah supporters living abroad, particularly from Lebanese nationals living in Africa, South America and other places with large Lebanese Shia expatriate communities. Hezbollah's main income, according to Hezbollah Parliamentarian Mohammad Raad, comes from the groups own investment portfolios and wealthy Shias.[25]

Take the example of the case of the Union Transport Africaines (UTA) Flight 141, bound for Beirut, which crashed on take-off from Cotonou in Benin, West Africa on 25 December 2003. According to accounts in the Arab press, a "foreign relations official of the African branch of the Lebanese Hezbollah party and two of his aides" were among those killed.[26] Arab press reports also claim the Hezbollah officials were carrying US$2 million in contributions, raised from wealthy Lebanese nationals living in Africa, to the organization's headquarters in Beirut.

Arab media reports regarding the US$2 million that Hezbollah lost in the aircraft crash noted that "this amount represented the regular contributions the party receives from wealthy Lebanese nationals in Guinea, Sierra Leone, Liberia, Benin, and other African states."[27] The fact that

Hezbollah immediately sent an envoy to Benin "to console the sons of the Lebanese community" indicates the value that the group places on these expatriate communities.[28]

As is the case among all terrorist groups that raise funds under the cover of charitable giving, some donors are defrauded unwittingly into funding terrorism while others are willing participants in Hezbollah's financing schemes. As the Israeli estimate suggests, the transfer of US$2 million at once and by human courier—is remarkable in its audacity. The last known transfer of this size occurred in 1998, when Lebanese expatriates in Senegal attempted to smuggle approximately US$1.7 million to Lebanon.[29] At the time, the local community claimed the smuggling operation was merely an attempt to evade Senegalese law, not to finance Hezbollah. Israeli intelligence, however, ranks Senegal as the "secondary centre for Hezbollah's fundraising activity in Africa" after the Ivory Coast.[30] An Israeli intelligence report focusing on Hezbollah fundraising operations in the Ivory Coast, Senegal, the Democratic Republic of Congo (formerly Zaire) and South Africa estimated that the organization raises "hundreds of thousands of U.S. dollars yearly" on the continent.[31] The sum would be higher had more attempts to smuggle such remittances to Hezbollah succeeded.

Hezbollah supporters living in the U.S. also sent remittances back to Lebanon to fund Hezbollah activities. For example, in Charlotte, NC Hezbollah support networks organized regular parlor meetings held in members' homes where a collection basket was passed around after watching Hezbollah propaganda videos, usually produced by al-Manar.[32]

Similar activity has been documented in South America, where authorities investigating the activities of Hezbollah operative Assad Barakat noted his involvement in "a network of economic financing, that would have as its center of operations Ciudad del Este, Paraguay, which would be sending funds to Lebanon disguised as benefiting the families of victims of the conflict with Israel. It is fitting to mention that the remittances have as their destination relatives fallen in terrorist acts and the economic strengthening of Hezbollah."[33] Argentinean officials express similar concern about Hezbollah activity in Ciudad del Este. Mario Baizan, a former Argentine presidential advisor, described the city as "one of the world's biggest centers for financing of the pro-Iranian militant group Hezbollah."[34]

CHARITIES AND FRONT ORGANIZATIONS

Hezbollah uses charities and front organizations to conceal its fundraising activities, although it is less reliant on charities that groups like Hamas due to its annual subsidies from Iran and significant involvement in criminal enterprises. Take, for example, the al-Aqsa International Foundation, a terrorist front organization banned by the United States, Germany and Great Britain (though not the European Union). While al-Aqsa primarily served as a Hamas front organization, Sheikh Moayad, the head of the al-Aqsa office in Yemen, was arrested in Germany and extradited to the United States for providing financial support to al-Qaeda. Moayad proudly told an undercover FBI informant that he not only funded Hamas but also raised millions of dollars, recruited operatives, and provided weapons to al-Qaeda. According to one report, one of the foundation's offices in Europe also raised funds for Hezbollah.[35]

The "Martyr's Organization" (Bonyad-e Shahid), headed by Mohammad Hasan Rahimiyan, admittedly supplies charitable funds for the family of suicide bombers. In 2001, Paraguayan police searched the home of Hezbollah operative Sobhi Mahmoud Fayad in Ciudad Del Este, a town along the tri-border area where the borders of Brazil, Argentina, and Paraguay meet. Searching Fayad's home, police found receipts from the Martyr's Organization for donations Fayad sent totaling more than $3.5 million dollars.[36] Authorities believe Fayad sent over $50 million to Hezbollah since 1995. According to press reports, Iran has traditionally funded Palestinian dissident groups in the Lebanese refugee camps, including al Maqdah, through the Institute of the Palestinian Martyrs.[37]

According to a declassified research report based on Israeli intelligence Hezbollah also receives funds from charities that are not directly tied to Hezbollah but are radical Islamist organizations and donate to Hezbollah out of ideological affinity. "Besides operating a worldwide network of fundraisers, funds are also raised through so-called 'charity funds.' Some of these are extremist Islamic institutions that, while not directly connected to Hezbollah, support it, albeit marginally, in view of their radical Islamic orientation."[38] The report cites many such charities worldwide, including four in the Detroit area alone: The Islamic Resistance Support Association, the al-Shahid Fund, the Educational Development Association (EDA) and the Goodwill Charitable Organization (GCO). Also cited are the the al-Shahid Organization in Canada, the Karballah Foundation for Liberation in South Africa, the Lebanese Islamic Association and al-Shahid Social Relief Institution in Germany, and the Lebanese Welfare Committee, The Help Foundation and The Jam'iyat al-Abrar (Association of the Righteous) in Britain.

While some of these funds undoubtedly paid for Hezbollah's military and terrorist operations, other funds enable the group to provide its members with day jobs, to drape itself in a veil of legitimacy, and to build grassroots support among not only Shia but Sunni and Christian Lebanese as well. For example, Hezbollah runs the al-Janoub hospital in the southern Lebanese city of Nabatiyah—one out of a network of some fifty hospitals the group runs throughout the country. The hospital receives $100,000 a month from Hezbollah and is run by Ahmad Saad, the hospital director who is also a member of Hezbollah's "national health committee."[39]

In light of its support from Iran, Hezbollah needs not rely on charities to raise funds as much as other groups like al Qaeda or Hamas. Nonetheless, as Assistant Secretary of State E. Anthony Wayne testified before Congress in September 2003, donating money to charities affiliated with terrorist groups like Hamas or Hezbollah frees up existing monies to support the group's terrorist activities. "If you are funding the organization, even if there are many charitable activities going on, there is some fungibility between funds. You are strengthening the organization."[40] Moreover, such funds are objectionable in their own right when they build grassroots support for terrorist organizations and subsidize the families of suicide bombers.

According to U.S. intelligence officials, "Hizbullah maintains several front companies in sub-Saharan Africa".[41] Little information is available on these purported fronts, though they are widely assumed to include import-export companies (an established terrorist modus operandi). These officials say that many Hezbollah activists in the tri-border region relocated to Africa and other locations as a result of the increased attention drawn to Hezbollah activity after the group's role in the 1992 and 1994 truck bombings in Argentina. In an effort "not to have all their eggs in

one basket", one analyst adds, some Hezbollah operatives have "moved on" from locations in South America and Europe and set up shop in Africa, Asia and less conspicuous parts of South America.[42]

CRIMINAL ENTERPRISES

Hezbollah depends on a wide variety of criminal enterprises, ranging from smuggling to fraud to drug trade to diamond trade in regions across the world, including North America, South America, and the Middle East, to raise money to support Hezbollah activities. Published reports even suggest that Al-Qaida and Hezbollah have formed additional tactical, ad-hoc alliances with a variety of terrorist organizations to cooperate on money laundering and other unlawful activities.[43]

In the United States, law enforcement officials are investigating a variety of criminal enterprises suspected of funding Middle Eastern terrorist groups, including the stealing and reselling of baby formula, food stamp fraud, and scams involving grocery coupons, welfare claims, credit cards, and even unlicensed t-shirts sales. U.S. officials believe "a substantial portion" of the estimated millions of dollars raised by Middle Eastern terrorist groups comes from the $20 million to $30 million annually brought in by the illicit scam industry in America.[44] Prominent examples include an Arab-American in Detroit caught smuggling $12 million in fraudulent cashiers checks into the United States, and a fitness trainer in Boston accused of providing customers' social security and credit card numbers to Abd al-Ghani Meskini, an associate of Ahmad Ressam, the Algerian convicted of plotting to blow up Los Angeles international airport in 2000.[45] A senior U.S. law enforcement official concluded, "There is a significant amount of money moved out of the United States attributed to fraud that goes to terrorism."[46]

The most outstanding case in North America is the Charlotte, North Carolina, cell run by two brothers, Mohammed and Chawki Hamoud. In June 2002, the Hamoud brothers were convicted of a variety of charges including funding the activities of Hezbollah from the proceeds of an interstate cigarette smuggling ring. Seven other defendants pled guilty to a variety of charges stemming from this case, including conspiracy to provide material support to terrorists, cigarette smuggling, money laundering and immigration violations.[47] Mohammed Hassan Dbouk and his brother-in-law, Ali Adham Amhaz, ran the Canadian portion of this network under the command of Haj Hasan Hilu Laqis (Hezbollah's chief military procurement officer). Their activities were funded in part with money that Laqis sent from Lebanon, in addition to their own criminal activities in Canada (e.g., credit card and banking scams).[48] Among the items that they purchased in Canada and the U.S. and smuggled into Lebanon were night-vision goggles, global positioning systems, stun guns, naval equipment, nitrogen cutters and laser range finders. The Canadian Hezbollah network also sought to take out life insurance policies for Hezbollah operatives committing acts of terrorism in the Middle East.[49] According to a wiretapped conversation with another member of his cell that was summarized by Canadian intelligence, "Dbouk referred to a person down there [in Southern Lebanon] … who might in a short period of time go for a 'walk' … and never come back, and wondering if Said [the other cell member] could fix some papers and details … for him (person) and put himself (Said) as the reference."[50]

Members of the Charlotte cell entered the U.S. from South America using false documents and through sham marriages carried out in Cyprus. They conducted their activities under multiple identities. Cell members paid indigent Americans to travel to Cyprus at Hezbollah's expense and engage in sham marriages so additional operatives could get visas to come to America.[51]

In South America, Hezbollah operatives engage in a wide range of criminal enterprises to raise, transfer, and launder funds in support of their terrorist activities. These enterprises include, among others, mafia-style shakedowns of local Arab communities, sophisticated import-export scams involving traders from India and Hong Kong, and small-scale businesses that engage in a few thousand dollars worth of business but transfer tens of thousands of dollars around the globe.[52] In one case, Paraguayan officials arrested Ali Khalil Mehri for selling millions of dollars in pirated software and funding Hezbollah with some of the profits.[53] The tri-border area is especially important to Hezbollah, where the group raises close to $10,000,000 a year, according to a study produced by the U.S. Naval War College.[54]

According to the U.S. Treasury Department, Assad Barakat "threatened TBA [tri-border area] shopkeepers who are sympathetic to Hezbollah's cause with having family members in Lebanon placed on a 'Hezbollah blacklist' if the shopkeepers did not pay their quota to Hezbollah via Barakat."[55] The Treasury Department noted that Barakat is reported to be "the deputy to a Hezbollah financial director, Ali Kazan, and the primary liaison in the TBA for Hezbollah's Spiritual Leader Hussein Fadlallah."[56] Barakat not only served as a treasurer for Hezbollah, he was also "involved in a counterfeiting ring that distributes fake U.S. dollars and generates cash to fund Hezbollah operations" and personally couriered contributions to Lebanon for Hezbollah.[57] Barakat's personal secretary, Sobhi Mahmoud Fayad, served as Hezbollah's military leader in the tri-border region. Fayad was arrested at least three times since 1999, including once for surveilling the U.S. embassy in Asuncion.[58]

Hezbollah activities in Latin America, however, are by no means limited to the tri-border area. Chilean officials have identified several import-export companies, primarily located in free trade zones such as the Iquique Free Trade Zone (ZOFRI) in northern Chile, that are suspected as serving as either front organizations or shell companies for Hezbollah. These include Kalmiar Ltd, Bahamas Ltd., Las Vegas Nevada Ltd., San Francisco Ltd., Saleh Trading Ltd., Frankfourt Ltd., Guarany Ltd., Teen Chile Ltd., and Lucky Crown Ltd.[59]

According to Chilean law enforcement officials, "starting in 1980 Lebanese members of Hezbollah have been expanding its presence in South America and continue developing its network of contacts in the Triple Border area."[60] In 1994 and 1995, these officials note, Hezbollah operatives began visiting Chile "to establish a new operational center for the development of their activities since the authorities of the Triple Border countries initiated greater and more rigorous control with respect to the activities of these foreigners, especially the Lebanese, who according to information provided by international security services are associated with terrorist members of Hezbollah."[61] According to a U.S. Naval War College report, "U.S. Southern Command estimates that Islamist terrorist groups raise between three hundred million and five hundred million dollars per year in the Triple Frontier and the duty-free zones of Iquique, Colon, Maicao, and Margarita Island."[62]

Hezbollah members in Venezuela—centered within the large Lebanese expatriate community on Margarita Island—helped several members of the Hezbollah cell in Charlotte, North Carolina infiltrate into the United States through Venezuela in 1992.[63] In the free trade area of Maicao, Columbia, Hezbollah is believed to participate in cigarette smuggling and may have operated a clandestine radio station broadcasting the group's propaganda.[64]

Hezbollah also raises money from drugs and conflict diamonds to support its operations. Hezbollah benefits both financially and operationally from the Beka'a Valley's poppy crop, which the group trades to Israeli-Arabs for intelligence on Israeli infrastructure and placement of Israeli soldiers. Israeli authorities have broken up a series of Israeli-Arab cells working for Hezbollah in return for money and, frequently, drugs. Some of these cells, like one operating out of the Galilee village of Abu Snan, were planning to kidnap Israeli soldiers. In September 2002, an Israeli military court indicted a Lieutenant Colonel in the Israeli army, part of a ten member gang, for spying for Hezbollah. The officer, who reportedly lost an eye fighting Hezbollah guerillas, passed classified information to Hezbollah operatives in return for money, hashish and heroin.[65] Hezbollah benefits from the drug business in Lebanon (which in turn is linked to the group's activities in other drug producing areas like South America and Southeast Asia).[66]

Hezbollah and other terrorist groups also traffic narcotics in North America to fund their activities back in the Middle East. A Drug Enforcement Administration (DEA) investigation into a pseudoephedrine smuggling scam in the American Midwest led investigators as far as Jordan, Yemen, Lebanon, and other Middle Eastern countries, including bank accounts tied to Hezbollah and Hamas. DEA chief Asa Hutchinson confirmed, "a significant portion of some of the sales are sent to the Middle East to benefit terrorist organizations."[67]

Long before al Qaeda was suspected of converting cash into easily transportable commodities like diamonds, Hezbollah learned to raise significant funds by dealing in so-called 'conflict diamonds' in Sierra Leone, Liberia , and Congo.[68]

In his U.S. Senate testimony on the links between conflict diamonds and terrorism the former U.S. ambassador to Sierra Leone, Joseph Melrose Jr., and the former Sierra Leonean ambassador to the US, John Leigh, confirmed that diamonds mined in Sierra Leone finance the activities of terrorist groups such as Hezbollah and al-Qaeda.[69]

According to David Crane, prosecutor for the Special Court in Sierra Leone: "Diamonds fuel the war on terrorism. Charles Taylor is harbouring terrorists from the Middle East, including al-Qaeda and Hizbullah, and has been for years."[70] Moreover, a July 2000 Belgian intelligence report stated that "there are indications that certain persons, the 'Lebanese connection' mentioned in the diamond smuggling file, also put in an appearance in files on money laundering, the drugs trade and the financing of Lebanese terrorist organisations such as Amal and Hizbullah."[71] Belgian intelligence reports also tie the Congolese diamond trade to the financing of various terrorist groups including Hezbollah.[72]

Speaking in the context of the diamond trade and its links to Middle Eastern terrorist groups, one official recently noted the "influx of hard-core Islamist extremists" in the Congo, over the past three years. He added, "We know Hezbollah is here, we know other groups are here, but they can

probably operate a long time before we know enough to stop them."[73] The movement of Hezbollah operatives to Congo in the late 1990s and early 2000s is significant, given the rebellions that divided the country after the end of Mobutu Sese Seko's dictatorship in 1997.

Hezbollah operatives also run otherwise legitimate business enterprises that function as shell companies or fronts for raising, laundering and transferring large sums of money. The most egregious example appears to be the use of Western Union offices by local Hezbollah operatives. Though Western Union officials were not complicit in this activity, the company failed to make any real efforts to vet local operators even as their international operations grew exponentially over a few short years, especially in areas of conflict.[74] According to Israeli officials, Hezbollah operatives run several Western Union offices in Lebanon and use the co-opted services of others worldwide, especially in Southeast Asia. In some cases, where the local Western Union agent is a Hezbollah member or supporter, experts believe Hezbollah gets a cut of the 7% service fee charge split between Western Union and the local agent. In other cases, Hezbollah simply uses the money wiring company to launder and transfer funds. For example, Hezbollah funding to Palestinian terrorist groups in the West Bank is almost entirely transferred via Western Union – including some $3 million over a one year period in 2003-2004 alone.[75]

CONCLUSION

According to a former senior law enforcement official, "Hezbollah is very criminally-oriented for its fundraising in the United States, including legitimate and illegitimate business activities."[76] The members of the Charlotte cell, for example, raised significant sums of money for Hezbollah but used some of their earnings to buy nice houses and lead what appeared to be normal, middle-class American lives. Despite all the money the group receives from Iran, Hezbollah activists in the United States are believed to be self-funding, mostly through criminal enterprises.

Interestingly, while engaging in criminal activity often increases a group's vulnerability by further exposing them to the scrutiny of law enforcement authorities, Hezbollah's reliance on fellow sympathizers and members of local expatriate communities minimizes that potential exposure. Still, as the case of Hezbollah criminal activity in the tri-border region of South America makes clear, the group does engage in criminal activities that gave rise to the unwanted attention of local and international authorities, including mafia-style shakedowns of local store-owners, illegal pirating of multimedia, and the international drug trade. Moreover, as the Charlotte case highlighted, there are cases in which even sympathizers and members of close-knit communities can be convinced to break with their fellow Hezbollah supporters and cooperate with law enforcement authorities.

Cracking down on Hezbollah's proactive involvement in criminal enterprises in the United States has been and should continue to be a focus of U.S. law enforcement authorities' strategy for combating the group's presence in this country and its effectiveness abroad.

[1] This testimony draws heavily on the author's chapter "Hizballah Finances: Funding the Party of God," in *Terrorism Financing and State Responses in Comparative Perspective* (forthcoming 2006)
[2] Julie Sawyer and Andrew Eastman, research assistants in The Washington Institute's terrorism studies program, assisted in the preparation of this testimony.
[3] . "U.S. Deputy Secretary of State: Hizbalah—"A Team of Terrorism," www.Albawaba.com, September 6, 2002; "Hezbollah Says Will Defend Lebanon from U.S. Threats," Reuters, September 6, 2002.
[4] See Matthew Levitt, "Hizbullah's African Activities Remain Undisrupted," *RUSI/Jane's Homeland Security and Resilience Monitor,* March 1, 2004 (posted online February 4, 2004); Matthew Levitt, "Smeared in Blood, Hezbollah Fingerprints All Over Globe," *The Australian,* June 9, 2003; Ely Karmon, *Fight on All Fronts: Hezballah, The War on Terror, and the War in Iraq,* Policy Focus No. 46, The Washington Institute for Near East Policy, December 2003.
[5] "Current and Projected National Security Threats to the United States," Hearing Before the Select Committee on Intelligence of the United States Senate, February 6, 2002 (see response number 3 to "Questions for the Record" on page 339 of GPO print edition).
[6] "Threats to National Security," Hearing before the Senate Armed Services Committee of the United States Senate, February 12, 2003.
[7] See Matthew Levitt, "Hezbollah: A Case Study of Global Reach" Remarks to a conference on "Post-Modern Terrorism: Trends, Scenarios, and Future Threats," International Policy Institute for Counter-Terrorism, Herzliya, Israel, September 8, 2003 available online at http://www.washingtoninstitute.org/media/levitt/levitt090803.htm
[8] "Treasury Designates Six Al-Qaeda Terrorists," U.S. Department of the Treasury press release (JS-757), September 24, 2003. Available online: http://www.treasury.gov/press/releases/js757.htm
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[10] *The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States,* available online at http://www.9-11commission.gov/report/index.htm
[11] Scott Wilson, "Lebanese Wary of a Rising Hezbollah," *The Washington Post,* December 20, 2004, A17
[12] "Iran Expands its Palestinian Control; Offers al-Khadoumi Five Million Dollars," *al-Watan* (Kuwait), December 13, 2004.
[13] "Iran Establishes Rocket Training Centers in Lebanon," *Middle East Newsline,* August 8, 2002.
[14] Nicholas Blanford, "Report Claims Iran Running Bekaa Training Camp," *Daily Star* (Beirut), August 13, 2002 (the article also appeared in Arabic in the Beirut daily An Nahar, August 13, 2002).
[15] Jorisch interview with Lebanese Hezbollah expert, October 11, 2002 in Avi Jorisch, *Beacon of Hatred: Inside Hezbollah's al-Manar Television* (Washington, DC: Washington Institute for Near East Policy, 2004), Page 32. Nicholas Blanford, "Hezbullah Sharpens Its Weapons in Propoganda War," *Christian Science Monitor,* December 28, 2001 in Jorisch, Page 32.
[16] Robert Fisk, "Television News Is Secret Weapon of the Intifada," *The Independent* (London), December 2, 2000 in Jorisch, Page 32.
[17] Hamid Ghiryafi, 'Hizbullah Officials Carrying Donations Reportedly Killed in Lebanese Plane Crash,' al-Siyasah (Kuwait ) 29 December 2003 [FBIS].
[18] Mark S. Steinitz, "Middle East Terrorist Activity in Latin America," Policy Papers on the Americas, Vol. XIV, Study 7, Center for Strategic and International Studies, July 2003.
[19] Hezbollah: A Case Study of Global Reach.
[20] Copy of receipt, presented as evidence in U.S. v. Mohammed Hammoud, in author's personal files.
[21] Scott Wilson, "Lebanese Wary of a Rising Hezbollah," *The Washington Post,* December 20, 2004, A17.
[22] Mark S. Steinitz, "Middle East Terrorist Activity in Latin America," Policy Papers on the Americas, Vol. XIV, Study 7, Center for Strategic and International Studies, July 2003.
[23] Paul D. Taylor, Editor, "Latin American Security Challenges: A Collaborative Inquiry from North and South," Newport Paper No. 21, Newport Papers, Naval War College, 2004.
[24] Author interview with Israeli officials, Tel Aviv, May 2004.
[25] Scott Wilson, "Lebanese Wary of a Rising Hezbollah," *The Washington Post,* December 20, 2004, A17.
[26] Hamid Ghiryafi, 'Hizbullah Officials Carrying Donations Reportedly Killed in Lebanese Plane Crash,' *al-Siyasah* (Kuwait ) 29 December 2003 [FBIS].

[27] Hamid Ghiryafi, 'Hizbullah Officials Carrying Donations Reportedly Killed in Lebanese Plane Crash,' al-Siyasah (Kuwait ) 29 December 2003 [FBIS].
[28] Miriam Karouny, 'Benin Plane Crash Deaths Rise to 111,' Reuters 26 December 2003.
[29] Author interview with Israeli intelligence official, Tel Aviv, July 2003; also see Hizbullah (Part I),' op cit.
[30] Hizbullah (Part I),' op cit.
[31] Hizbullah (Part I): Profile of the Lebanese Shiite Terrorist Organization of Global Reach Sponsored by Iran and Supported by Syria," Special Information Bulletin, Intelligence and Terrorism Information Center at the Center for Special Studies, (CSS), Israel, June 2003, available online at http://www.intelligence.org.il/eng/bu/hizbullah/hezbollah.htm.
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[34] Sebastian Rotella, "Jungle Hub for World's Outlaws," *Los Angeles Times,* August 24, 1998, A1.
[35] USA vs. MOHAMMED ALI HASAN AL-MOAYAD, Affidavit in Support of Arrest Warrant, E astern District of New York, January 5, 2003; Hizbullah (Part I): Profile of the Lebanese Shiite Terrorist Organization of Global Reach Sponsored by Iran and Supported by Syria," Special Information Bulletin, Intelligence and Terrorism Information Center at the Center for Special Studies, (CSS), Israel, June 2003, available online at http://www.intelligence.org.il/eng/bu/hizbullah/hezbollah.htm.
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[37] "PLO Bids to Win Back Refugee Support," *Agence France-Presse,* July 5, 1994; Muntasser Abdallah, "Iran Pours Thousands of Dollars in Lebanon's Palestinian Camps," *Agence France-Presse,* June 21, 2002.
[38] Hizbullah (Part I): Profile of the Lebanese Shiite Terrorist Organization of Global Reach Sponsored by Iran and Supported by Syria," Special Information Bulletin, Intelligence and Terrorism Information Center at the Center for Special Studies, (CSS), Israel, June 2003, available online at http://www.intelligence.org.il/eng/bu/hizbullah/hezbollah.htm.
[39] Scott Wilson, "Lebanese Wary of a Rising Hezbollah," *The Washington Post,* December 20, 2004, A17.
[40] Testimony of E. Anthony Wayne, Assistant Secretary of State for Economic and Business Affairs, Department of State, to the House of Representatives Committee on Financial Services, September 24, 2003.
[41] Author interview with U.S. intelligence official, Washington, DC, July 2003.
[42] Author interview with U.S. intelligence official, Washington, DC, July 2003.
[43] Maurice R. Greenberg, Chair, "Terrorist Financing: Report of an Independent Task Force Sponsored by the Council on Foreign Relations," The Council on Foreign Relations, October 2002. Available online at http://www.cfr.org/publication.php?id=5080.
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[45] John Solomon, "U.S. Builds Terror Funding Cases," the Associated Press, August 28, 2002.
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[48] United States v. Mohamad Youssef Hammoud, et al. United States Court of Appeals for the Fourth District; . Jeffrey Goldberg, 'In the Party of God, Hizbullah Sets Up Operations in South America and the United States', the *New Yorker* 28 October 2002.
[49] United States v. Mohamad Youssef Hammoud, et al. United States Court of Appeals for the Fourth District.
[50] Transcript of Canadian Secret Intelligence Service (CSIS) transcript for Wednesday, May 26, 1999, author's personal files.
[51] United States v. Mohamad Youssef Hammoud, et al. United States Court of Appeals for the Fourth District.
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[53] Mark S. Steinitz, "Middle East Terrorist Activity in Latin America," Policy Papers on the Americas, Vol. XIV, Study 7, Center for Strategic and International Studies, July 2003.
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[65] Dina Kraft, "Seven Israeli Arabs Charged with Spying for Lebanese Guerillas," Associated Press Worldstream, November 29, 2000; James Bennet, "Israeli Bedouin Colonel Is Formally Charged With Spying," the *New York Times,* October 25, 2002.
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[68] "For a Few Dollars More: How al Qaeda Moved into the Diamond Trade," Global Witness, April 2003, available online at http://www.globalwitness.org/reports/show.php/en.00041.html
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[71] "Angolan Diamond Smuggling: The Part Played by Belgium ('Algemene Dienst Inlichting En Veiligheid (Adiv)'), Service General du Renseignement Et de la Security (Sgr), July 2000, included in 'For a Few Dollars More: How Al-Qaeda Moved into the Diamond Trade,' Global Witness April 2003, available online at www.globalwitness.org/reports/show.php/en.00041.html
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[74] Glenn R. Simpson, "Expanding in an Age of Terror, Western Union Faces Scrutiny as Fund-Transfer System Grows In Risky Parts of the World," the *Wall Street Journal,* October 20, 2004.
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# COUNTERFEIT GOODS: EASY CASH FOR CRIMINALS AND TERRORISTS

**Written Testimony of**

**Timothy P. Trainer**
**President**
**Global Intellectual Property Strategy Center, P.C.**

**Before the**
**United States Senate**
**Committee on Homeland Security and Governmental Affairs**

**May 25, 2005**

Mr. Chairman and members of the Committee, this hearing to examine trademark counterfeiting and its relationship to organized crime and terrorism is extremely important in view of the global onslaught to steal these valuable assets.

I take this opportunity to submit these comments due to the ongoing global assault on trademark assets owned by U.S. companies, large and small, and companies elsewhere that are victimized by counterfeit goods. These comments are not submitted on behalf of any entity, but are offered due to my continuing work in the area of intellectual property enforcement. My work in this area has included both public (U.S. Customs Service and the U.S. Patent and Trademark Office) and private (Arter & Hadden law firm and the International Anti-Counterfeiting Coalition, Inc.) experience.

In part, I restate the testimony presented on March 23, 2004, before the Senate Judiciary Committee as well as the testimony I presented before the U.S. China Commission in February this year.

***RECOMMENDATIONS***

At the outset, these recommendations are put forward for further consideration by this Committee, the Administration and industry to combat the scourge of counterfeiting and piracy that exist and will be elaborated upon further in the following pages:

- Take immediate steps to introduce a Senate companion to H.R. 32 "Stop Counterfeiting in Manufactured Goods Act";
- Protect IP rights as part of C-TPAT and CSI programs;
- Impose aggressive IP enforcement provisions, including enforcement in free trade zones, on trading partners entering into bilateral trade agreements with the U.S. ;
- Increase efforts to have trading partners improve enforcement at the border;
- Request less burdensome enforcement data from industry;
- Seek immediate increase in criminal enforcement in China; and
- Consider whether notions of territoriality prevent small and medium enterprises from obtaining effective enforcement in foreign markets.

***1. GENERAL BACKGROUND***

Trademark counterfeiting is as complex and difficult to combat as copyright piracy. While copyright owners confront pirates who use technology to steal content before products are available to consumers,[1] trademark owners are also combating sales of counterfeit goods on the internet[2] and the manufacture, distribution and sale of physical

[1] See, Joshua Chaffin and Scott Morrison "Online Pirates Beat Star Wars Rush for Premiere," Financial Times (May 19, 2005). "Online pirates beat the rush to the theatre and were already downloading the film from file-sharing websites on Wednesday".

[2] "Golfers Get Clubbed by Cheap Chinese Knock-offs," The Globe and Mail (May 18, 2005). Internet auction sites offer counterfeit golf clubs, motivating Callaway, Nike and others to combat counterfeiters together.

goods around the world. In view of the counterfeiters' expansion into more product areas, the paramount issue related to trademark counterfeiting, i.e., product counterfeiting, is public health and safety as all types of products are now being counterfeited:

- Pfizer's Vice Chairman states that between 10% and 15% of all drugs sold in the world are fakes;[3]
- Fourteen died from fake alcohol in China;[4]
- CBS's Chicago affiliate uncovers counterfeit extension cords in discount stores;[5]
- Police arrest individuals involved in dealing in counterfeit cosmetics;[6]
- Approximately $10 million dollars worth of fake auto parts seized (filters, pistons, brake pads, and more) in the United Arab Emirates, including tens of thousands of counterfeit GM products;[7]
- South African authorities uncover tons of staple foods bearing fake marks;[8]
- "Disney Acts on Fake Asian Toys";[9]
- Hair dryers and extension cords found bearing counterfeit UL marks seized in Canada;[10]
- Counterfeit shampoos and hair oils concern Indian industries;[11]
- "Unsafe condoms sold under Durex name";[12]
- Counterfeit Kiwi shoe polish, power drills, motor oil, and teas are subject to counterfeiting;[13] and
- Authorities seize counterfeit shampoos, creams, toothpaste, soaps and hair oil found in warehouses in Sharjah, UAE.[14]

From a public policy perspective, these examples provide ample reason for increased government enforcement efforts as counterfeiters continue to invade a broad array of product areas and put consumers in harm's way.

In addition to the public health and safety risks related to counterfeiting, there is the continuing reference to organized crime involvement. The U.S. Attorney's office in New York charged 51 individuals, arresting 29, from rival Chinese gangs for their involvement in international smuggling activities and gambling. The charges involved smuggling immigrants and importing counterfeit goods from China, as well as additional charges for

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[3] Agence France Presse (May 18, 2005).
[4] Xinhua News Agency (May 18, 2005).
[5] CBS News, Chicago CBS Channel 2 (May 9, 2005).
[6] The Monitor (Uganda) (May 5, 2005).
[7] Gulf News (April 19, 2005).
[8] Sunday Independent (Johannesburg) (April 17, 2005).
[9] Dominion Post New Zealand (April 13, 2005) (Disney acts because of small parts that pose a choking hazard and paints with high levels of metal such as lead.).
[10] Ottawa Citizen (April 2, 2005).
[11] Financial Times (March 17, 2005).
[12] Irish Times (March 15, 2005).
[13] Business Week (February 7, 2005).
[14] Khaleej Times (August 17, 2004).

attempted murder, extortion and money laundering.[15] The recognition of the organized crime element is not limited to the United States and Western Europe. Recently, authorities in the Philippines have expressed their belief that Chinese-Filipino syndicates are flooding Philippine markets with counterfeit goods, ranging from clothes and shoes to medicines from China.[16]

Adding to the organized crime and dangerous products concerns arising from counterfeits is yet another issue that raises social issues: child labor. Reports have begun to surface that underage children are employed by those engaged in the production and distribution of counterfeit and pirate product. Industry[17] and a human rights organization[18] have raised this issue as it relates to China. However, it is not limited to China as other reports have been provided by industry to trade associations regarding the use of underage children to be runners and look-outs in South America.[19]

As trade in counterfeiting and piracy continue to expand and envelope ever more criminal activities, the cases of authorities detecting more shipments attempted to be transported across borders increase. During the first three-quarters of 2004, the European Union's national border enforcement authorities conducted over 16,300 enforcement actions resulting in the seizure of over 74 million counterfeit and pirated items.[20] Japan's Ministry of Finance reported record seizures of counterfeit and pirated products at its borders for 2004, reporting a 23% increase over 2003 with seizures of goods from China doubling.[21] The Bureau of Customs and Border Protection, U.S. Department of Homeland Security, reported that for fiscal year 2004, Customs seized over 7,200 shipments containing counterfeit and pirate goods, valued at over $138 million dollars.

While understandable that the American, European and Japanese markets would be targets of counterfeiters, even Malta is now finding significant quantities of counterfeits. In a five month period, Malta's authorities have detected the equivalent of 14 full containers of counterfeit goods.[22] The goods are usually from the Far East and destined for other markets.

Rich and poor countries alike are combating the massive movement of counterfeit and pirate products. This brief snapshot of some of the counterfeiting and piracy activity provides a glimpse into a bad situation that appears to be getting worse, not better. The ongoing counterfeiting enterprises continue because of the continuing large scale profits that can be realized in the face of weak enforcement efforts and non-deterrent penalties.

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[15] Julia Preston, "U.S. Charges 51 with Chinatown Smuggling," New York Times (November 13, 2004).
[16] Manila Standard (April 28, 2005).
[17] Evening Standard (London) (February 11, 2005).
[18] Daily Mail (UK) (March 14, 2005).
[19] In February 2005, the International AntiCounterfeiting Coalition, Inc., asked its member companies to provide any information they might have regarding the involvement of child labor in counterfeiting and piracy. Responses were limited.
[20] http://europa.eu.int/comm/taxation_customs/counterfeit_piracy
[21] Daily Yomiuri (Tokyo) (April 4, 2005).
[22] Paul Cachia, Di-ve News (May 17, 2005)

There is no doubt that industry and government must redouble their efforts in various areas in order to make "progress", which in some countries is simply slowing the growth rate of counterfeiting. Unfortunately, the list of substandard and dangerous products made and distributed around the world makes anyone anywhere a potential victim of counterfeit products.

### *2. LEGISLATION*

In the United States, legislation needs to be strengthened at all levels, local, state and federal. A recent traffic stop along Interstate 80 resulted in police charging two individuals who were found with $680,000 dollars worth of counterfeit luxury goods in their vehicle.[23] In November 2004, New York City's Comptroller estimated that the City loses over a billion dollars in tax revenues due to sales of counterfeit and pirate goods.[24] Both suggest that the statistics issued by the Bureau of Customs and Border Protection reflect a tiny fraction of the counterfeiting activity within the United States.

Strategies here and abroad suggest potential ways forward in combating counterfeiting and piracy. On April 19, 2005, trademark owner Louis Vuitton (LV) won a preliminary injunction against a landlord who owns seven storefronts on Canal Street in New York City. The landlord agreed to take action to prevent the sales counterfeit LV goods on his properties.[25] In Scotland, city council licensing officials have taken the unprecedented step of banning sales of DVDs, CDs, videos and computer games at a flea market in a crackdown on pirated goods, demonstrating the need for more aggressive enforcement actions.[26]

Government and industry must consider a combination of new and old approaches to combat counterfeiting and piracy, whether civil or criminal penalties. There is no doubt that in many cases of product counterfeiting, the individuals involved have no regard for either the consumer or the trademark owner. In recent years, there has been only one piece of federal legislation aimed at strengthening the criminal law against trafficking in trademark counterfeit goods. Both last year and this year, Representative Joe Knollenberg's "Stop Counterfeiting in Manufactured Goods Act" has been introduced.[27] It would strengthen the criminal provision, Title 18, U.S.C., Section 2320. The legislation, which was passed by the House of Representatives just days ago, does take steps forward to eliminate loopholes that currently exist. Therefore, companion legislation in the Senate is needed for this section of the federal criminal law to be strengthened.

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[23] Pittsburgh Post-Gazette (May 22, 2005). He Dejin and XiaoLaning charged with having counterfeit purses, watches and other items bearing Chanel, Coach, Prada, Burberry and Gucci marks.
[24] Eric Dash, "The Handbag? Total Knockoff. The Price Tag? All Too Real," New York Times (November 23, 2004).
[25] Julia Boorstin, "Louis Vuitton Tests a New Way to Fight the Faux," Fortune Magazine(May 3, 2005).
[26] Evening News (Edinburgh) (May 21, 2005).
[27] H.R. 32 was introduced in January 2005.

### *3. CBP INITIATIVES*

Recognizing that both the Container Security Initiative and the Customs-Trade Partnership Against Terrorism are intended to safeguard the United States from terrorist acts and weapons of mass destruction, these programs can also contribute greatly to our economic security with an emphasis on IP protection. In view of the huge quantities of counterfeit goods entering the U.S. market, these programs should not provide foreign exporters and domestic importers with "guarantees" of getting goods into the U.S. market once they become participants of these programs.

Despite the increased CBP IP seizure statistics for FY 2004, it is requested that Congress monitor these programs and require that these programs include a strong and aggressive IP enforcement component in order to combat counterfeiting and piracy. As noted in this submission, combating IP theft targets organized crime groups operating abroad that engage in other types of illegal activity. By looking at IP theft too narrowly, we fail to appreciate how criminals here and abroad use IP theft to fund other illegal conduct.

### *4. BILATERAL AGREEMENTS*

The strong enforcement provisions of the Free Trade Agreements (FTAs) that have been concluded are positive steps toward combating counterfeiting. Future FTAs should clearly indicate that, in addition to *ex officio* authority for goods intended for export and moving in-transit, goods in free trade zones are also subject to the same enforcement requirements.

Despite ongoing and aggressive efforts to address counterfeiting in the countries of manufacture, the concentration of Asian-made counterfeit goods being sent to every region of the world should be sufficient grounds to redouble the Administration's efforts to require improved enforcement in the countries of importation. Thus, all forms of bilateral trade agreements should be enhanced to heighten enforcement efforts at the border by all trading partners. Moreover, the obligation for *ex officio* criminal enforcement by our trading partners should be closely monitored to ensure that criminal IP theft is vigorously pursued.

### *5. GOVERNMENT REQUEST FOR DATA*

In September 2004, the Office of the U.S. Trade Representative (USTR) requested industry data regarding specific cases pursued in China. With the exception of a few, companies did not respond in sufficient numbers to provide USTR with a reliable picture of what happens to cases pursued in China. To some extent, detailed information on each case pursued by a company was deemed to be too burdensome for IP owners to respond. In the future, there may be alternative data elements that could be requested and still provide the type of "picture" of IP theft that is occurring and causing harm to companies or industry sectors. As an alternative, USTR could seek more general information from companies, for example:

1) Total number of raids in (name of country) (identify time period);
2) How many times a particular facility was raided/results;
3) Total of items seized/destroyed (identify type of product) (identify time period);
4) Total number of arrests;
5) How many cases were pursued with criminal investigations/prosecutions;
6) Disposition of defendants in administrative/criminal cases (e.g., level of fines imposed/paid, prison sentences imposed and served);
7) Information regarding the disposition of the equipment used to produce goods;
8) Information about facility (shut down or not);
9) Seizures of country X origin goods in 3d markets; and
10) Identify the type of IP (copyright, trademark, etc.) and, if a trademark, the marks used by the counterfeiters.

These data elements are suggested and would allow the submitting company (or companies in an industry sector) to submit aggregated data. Because these are not case specific, it might result in more industry representatives submitting data. It is not likely that any entity will be able to provide data as to all the elements above, but these or other data elements may be easier to obtain and to provide than the specific case information previously requested. Ultimately, industry should be able to develop its own data elements that it can provide either individually or as a group of affected companies.

### *6. CHINA CHALLENGE*

For most trademark owners, China continues to present the greatest challenge to efforts to protect and enforce their rights. Having said this, some trademark owners find other countries to be worse than China in their efforts to protect their rights.[28] Despite the chorus of complaints regarding deficiencies in China's domestic market and border enforcement systems, trademark owners have reported that

- Many raids have been conducted;
- Significant quantities of counterfeit goods have been seized;
- Criminal prosecutions have been initiated;
- Shipments have been stopped by Chinese Customs; and
- Prison sentences have been imposed.[29]

Still, China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. Despite significant improvements in China's IP legal regime over the last few years, the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.

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[28] *See*, International AntiCounterfeiting Coalition, Inc.'s (IACC) 2005 Special 301 submission and the Canada report at p. 8 (February 11, 2005). At the time of this submission, I was president of the IACC.
[29] China's official Xinhua News Agency reported on April 21, 2005, that over 50,000 trademark infringement and counterfeiting cases were investigated and dealt with in 2004.

The exports of counterfeit and pirated products continue to flow from China to every corner of the world causing lost sales and damage to brand image and, as noted above, pose health and safety concerns. China sourced counterfeits range from counterfeit medicines and auto parts to home electrical products to apparel and footwear.[30] China's counterfeiting industry has a direct impact on foreign governments. For FY 2004, the U.S. Department of Homeland Security's Bureau of Customs and Border Protection (CBP) reported the seizure of 2826 shipments from China containing counterfeit and pirated product, having a domestic value of over $87 million dollars.[31] Based on these statistics, China accounted for 63% of the total monetary value of intellectual property seizures in FY 2004. The export of counterfeit and pirate products impose significant pressures on foreign customs administrations and law enforcement entities to combat China's counterfeit exports.

While China's counterfeiting industry churns out massive amounts of counterfeit goods, the government has made changes to the legal regime. Two sets of changes involve the customs regulations and the recently issued judicial interpretations regarding criminal cases, the latter being issued in late December 2004.

The most recent amendments to the Customs regulations went into effect on March 1, 2004, and replaced earlier regulations from 1995 on the protection of IP rights by local customs offices. As a result of the regulatory changes, Customs issued new implementing rules that took effect July 1, 2004. Several issues remain problematic. The issues that continue to cause right owners problems are:

- The monetary range of the value of the bonds that can be required when ex officio action is taken (0% to 100% of the value of the counterfeits);
- Long term storage costs of the goods during the pendency of legal actions, which right holders believe should be paid by the infringers; and
- Auctioning of counterfeit goods rather than destruction of counterfeits as the routine remedy.

The result of some of the procedures now in place can deter right holders from using the enforcement system because it ties up valuable revenues. Given some of the expenses involved, e.g., storage, the right holder, not the infringer, continues to be subjected to additional further damage as the result of its effort to protect its rights.

Turning to the judicial interpretations concerning criminal enforcement, these were recently issued by the judicial authorities. The criminal enforcement system—police, prosecutors and the courts—will have to demonstrate a willingness to impose higher level penalties on counterfeiters and pirates. Any assessment of the future effectiveness of the new judicial interpretations should be accompanied by greater transparency of the judicial process so that right holders can more easily learn whether defendants receiving

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[30] *See*, "Fakes!", Business Week at p. 54 (February 7, 2005).

[31] Both of these statistical measures were increases over FY 2003 when CBP seized 2,056 shipments with a domestic value of over $62 million.

prison terms do, in fact, serve the prison sentences or pay monetary fines that are imposed.

While the problems in China's enforcement system are many, a basic starting point should be the consistent application of the enforcement mechanisms at all levels, city, provincial, and national. At these levels, the system must impose a level of penalty that will deprive the individuals involved of any economic benefit and impose a monetary fine or prison sentence so that the penalty is greater than the rewards of returning to the illegal activity of counterfeiting and piracy.

The new judicial interpretations continue to have obstacles to effective enforcement, including:

- Minimum thresholds for criminal liability;
- Significantly higher thresholds for corporate counterfeiters;
- Weak valuation of counterfeit goods—using the value of the illegal merchandise; and
- Reliance on an extensive administrative enforcement system.

Another significant gap in the interpretations is the absence of language addressing the problems caused by counterfeiters who operate underground factories/facilities without the necessary business/commercial licenses from the government. There should be no minimum monetary standard required for criminally pursuing counterfeiters who operate these types of underground facilities. Article 225 of the Criminal Code provides up to five years imprisonment for engaging in "illegal operations." While the Article 225 provisions may be intended for products specially regulated by the government (such as cigarettes, telecommunications and publishing), it should apply to all underground and illegal operations.

The text of the new interpretations, while important, should not be the sole focus of our efforts. Whatever steps the Chinese take – new regulations/interpretations, increased training, more funding, IP specialized PSB divisions, etc. -- such steps must result in more criminal prosecutions, heavier fines, more jail sentences and a reduction in the overall counterfeiting levels. The natural solution is for Chinese police to take a leading role in the investigation of counterfeiting cases. Additionally, the AICs, Customs, TSBs and other administrative enforcement bodies need to cooperate more closely with Chinese police and Public Security Bureaus (PSBs) and promptly transfer those cases that meet the standards for criminal investigation and prosecution.

The U.S. will have to continue its ongoing engagement with Chinese authorities, constantly identifying the obstacles to enforcement and how these obstacles can be reduced and eliminated. In order for the system to have the desired effect, the national government will have to ensure that its stated policy is implemented at all levels. Thus, greater political will should be demonstrated through more aggressive use of the criminal enforcement system.

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## 7. *IMPACT ON SMEs*

The China export machine has caused companies of all sizes to experience the counterfeiting problem. Companies that have any great national success within an industry and have risen to be a leader within an industry must increase their awareness of the possible threats posed by counterfeiters and pirates. Those that may not be active in multiple global markets may still be victims of IP theft simply due to their national success. Thus, a U.S. company that may not view itself as a global "player" can still have parts of its IP portfolio stolen and its future market taken.

Along these lines, the U.S. Government is increasing its efforts to raise awareness among small and medium enterprises (SMEs). Many successful SMEs may not be aware of the IP assets they have or how they might protect those assets. Thus, this requires a proactive education program. Because of today's technology and instant communication, a successful national enterprise can easily become a global target of counterfeiters.

The challenges posed by the massive quantities of counterfeit and pirated products made in China and elsewhere and exported throughout the world have exposed the IP system to a collision. Counterfeiters and pirates operating in China have swamped markets with substandard and dangerous products with no regard for national borders and with no respect for the rule of law. The speed with which IP criminals can be on the market has placed law abiding companies at an extreme disadvantage in combating IP crimes.

Because the global IP system has rules, legitimate IP owners that are the victims are also failing to make progress in this battle because of the territorial nature of some IP rules,[32] which help counterfeiters and pirates exploit an established system. In view of the current system where criminals make, trade and sell in practically every country, IP owners are disadvantaged because they are likely to receive protection of their rights only where Governments have granted rights. In view of the collision between the global scourge of counterfeiting and piracy and the territoriality of some types of intellectual property, perhaps it may be appropriate to consider how a distinction can be made between the acquisition of rights and the ability of IP owners to protect and enforce their rights so that protection and enforcement can be obtained in more countries in a timely fashion even absent the grant of rights in all the countries where one is victimized by counterfeiters.

For SMEs that do not have trademark registrations in dozens of countries, but whose success leads to criminal IP theft, there needs to be criminal enforcement against those who engage in global counterfeiting. Civil remedies will not deter today's criminal counterfeiter.

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[32] The territoriality of some types of intellectual property, e.g., patents and trademarks, hinder the ability of owners to seek protection and enforcement against counterfeiters.

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