

LOS ANGELES BUSINESS JOURNAL

[PRINT](#) | [CLOSE WINDOW](#)

Card Maker Decks U.S. Distributor

By JOEL RUSSELL - 3/1/2010

Los Angeles Business Journal Staff

In August 2008, an employee of Konami Digital Entertainment noticed something strange while visiting a Toys "R" Us store in the L.A. area.

Some packs of Yu-Gi-Oh cards, a popular fantasy game sold by Konami's Japanese parent company, looked odd.

The holographic logo on some of the cards appeared misaligned and they didn't have the correct color. In addition, the fonts looked wrong.

The employee bought the packs and took them to Konami's U.S. headquarters in El Segundo, where it was determined that some of the cards – specifically rare cards that players highly value – were counterfeit.

Then came the big shocker: Konami ultimately traced the maker of the bogus cards to Upper Deck Co. – its exclusive U.S. distributor, which had no right to manufacture any of its cards.

Over the next year or so, Konami discovered a lot more: namely that Upper Deck, a Carlsbad company that recently lost its right to produce cards for Major League Baseball, had manufactured some 611,000 rare cards without its permission.

Konami ended its business relationship with Upper Deck and sued the company in U.S. District Court in Los Angeles. The legal battle quietly came to a head in late January after a federal judge, in a summary judgment prior to trial, found that Upper Deck was liable for counterfeiting.

Depositions and evidence presented in court by Konami showed that Upper Deck went to great lengths to make the bogus cards – including assigning code names to the project, reproducing Konami's security foil and having the cards manufactured in China. An Upper Deck executive also testified that company founder, owner and Chief Executive Richard McWilliam directed the scheme.

The two sides reached a confidential settlement shortly after a jury was seated to consider how much damages Konami should be awarded. But in opening arguments prior to the settlement, Upper Deck's attorney made a stunning admission as he argued for jurors to minimize the damages, according to transcripts.

"I'm here defending a counterfeiter," said attorney Richard Howell of Rutan & Tucker in Costa Mesa. "We're talking about behavior that, from a defense attorney's standpoint, I can't defend, and I am not going to defend."

Upper Deck did have a broader defense, though: It claimed never to have sold the rare cards, but had them repackaged with more common cards as part what it calls an "unauthorized promotion" to unload slow-moving inventory. It called the cards "variants," not counterfeits. (Variant is a term used by Konami to describe any special card not distributed in a regular pack.)

"(Upper Deck) gave these cards away at no cost in order to move stockpiles of stale and growing inventory," said Howell, who went on to ask the jury to "do what is fair" when Konami made expected claims for "a lot of money, significant damages."

Still, Yumi Hoashi, vice president of cards at Konami, said executives at the U.S. subsidiary of Tokyo's Konami Corp. could hardly believe the situation.

"To say it was shocking is putting it mildly," Hoashi said. "They said they were taking steps to stop counterfeiting (by others), so to find they were doing it themselves was unbelievable."

'Making accusations'

In an e-mail to the Business Journal, Howell said Konami was blowing the case out of proportion, and that the settlement resulted in damages far less than the "hundreds of millions" that Konami publicly stated it was worth prior to the settlement. Upper Deck also stressed that the disputed cards were just a tiny fraction of the 500 million Yu-Gi-Oh cards it distributed in the U.S. in 2008.

"The only reason this case lasted as long as it did was because Konami's counsel spent far too much time running around making accusations in the press of so called 'eye-popping' and 'jaw-dropping' evidence against Upper Deck," said Howell in the e-mail.

"As the case drew closer and closer to trial, Konami finally began to realize that it was not going to be able to back up its outlandish claims. The court issued numerous rulings which gravely undermined the claims Konami had hoped to present during the trial. As a result of these events, Konami went into retreat and ended up requesting a settlement at half of what Upper Deck had been offering just days before."

In another e-mailed statement, CEO McWilliam reiterated Howell's point about the size of the settlement.

"When we realized the error of the unapproved promotion, we went to Konami to offer up a transfer of assets. ... We offered them an olive branch and they came back with a Sherman tank," McWilliam said. "So, after a long, hard battle, one of which Upper Deck was trying to avoid, the settlement amount for Konami, we believed, probably amounted to less than their attorneys' fees."

Benjamin Fox, a partner at Morrison & Forrester in Los Angeles who represented Konami in court, refused to discuss the negotiations or settlement, but noted that the judge found Upper Deck liable for counterfeiting.

"I take issue with their characterization of the discussions leading to the settlement, but I won't respond to them substantively," said Fox, who added that any discussion could be construed as violating the confidentiality agreement.

High-stakes game

While the case has drawn little attention, it has not gone unnoticed by the card industry.

Pete Williams, author of the book "Card Sharks: How Upper Deck Turned a Child's Hobby into a High-Stakes, Billion-Dollar Business," said the distrust from the Konami case spilled into Upper Deck's baseball card business.

In January, Upper Deck lost the exclusive contract to print cards for Major League Baseball, a right it had held for 22 years. Topps Co., the New York-based card publisher controlled by former Disney Chairman Michael Eisner, now has the MLB license.

Earlier this month, the league sued Upper Deck for continuing to make cards after its license expired showing official team logos and uniforms. The trademark infringement suit, filed in New York federal court, seeks unspecified damages and a court order to recall the logo-bearing cards. Upper Deck and its attorney declined to comment on the suit.

"This case has cost them relationships," claimed Williams. "Major League Baseball stripped them of their license, even though Upper Deck has been one of the league's top licensed revenue generators."

Yu-Gi-Oh is a children's game based on a popular Japanese Manga comic that debuted in 1996 – but the money is real for Konami and its distributors. Konami boasts of having sold some 22 billion cards

worldwide since introducing the card game in 1999. Yu-Gi-Oh also generated an animated TV show popular in the United States, Japan and elsewhere.

The U.S. subsidiary reported revenue of \$448 million in 2009, while the Tokyo parent, which trades on the New York Stock Exchange, reported \$3.15 billion.

In the Yu-Gi-Oh game, the cards represent creatures, powers or magical spells. Players, known as duelists, engage in fantasy battles by alternately playing cards until one player wins the duel. Each player assembles decks of 40 cards by selecting from among the 4,000 different card designs.

Packs of nine cards cost \$3.99, and buyers usually don't know what the pack contains until after purchase. Some cards are more powerful and rare than others, and these develop a higher value – from \$10 to \$70 per card – on the secondary market.

For the North American market, Konami said it has the cards made by third-party commercial printers under its direction. It contracted with Upper Deck to handle its North America distribution in 2002.

One of the two largest trading card companies in the world, Upper Deck was founded in 1988 and immediately revolutionized baseball cards with its flashy designs and focus on star players. It also pioneered cards in other sports – hockey, football, basketball and even NASCAR.

In fact, one reason it has been successful is that it owns a patented technology to authenticate the signatures of athletes. That capacity helped Upper Deck secure deals with stars such as baseball player Albert Pujols, golfer Tiger Woods and the Lakers' Kobe Bryant to put their signatures on special cards and sports memorabilia.

Indeed, Konami executives said one key reason Upper Deck was such a valued partner was because it always stressed a commitment to combating piracy.

"It was very disheartening to learn that a trusted business partner would take these actions to dupe us," Hoashi said.

During the early stages of the legal battle, Upper Deck emphasized the centrality of trust to its business model.

"The very notion that Upper Deck would engage in counterfeiting products is absurd," stated a letter presented to the court. "It begs the question as to why would Upper Deck risk its reputation and potential other licenses to sell counterfeit Yu-Gi-Oh trading cards that Upper Deck already has the exclusive authority to sell? Such conduct would potentially risk the viability of the entire company."

Elaborate scheme

However, according to court documents, Upper Deck put some of its expertise to use to reproduce nine extremely rare Yu-Gi-Oh cards, bearing names such as Elemental Hero Flame Wingman, Destiny Hero Dreadmaster and White-Horned Dragon. Most of the nine cards were originally designed by Konami for an approved promotional distribution with McDonald's Happy Meals.

According to testimony and documents presented in court, Upper Deck launched an elaborate plan to duplicate the cards and conceal the fact they were doing it. The scheme started when McWilliam asked one of his executives to obtain computer images for the rare cards. With the images in hand, Upper Deck then contracted a go-between company to secure and oversee a printer in China.

Upper Deck also purchased a special security foil used to make a holographic logo needed for each Yu-Gi-Oh card and had it shipped to the printer in China. In August 2007, an Upper Deck executive traveled to China to supervise the printing process.

When discussing the counterfeiting, Upper Deck executives used code names including the "Wizards in Training" program or simply the "secret project," according to court filings. Five Upper Deck executives refused to testify in the case, citing their Fifth Amendment right to not self-incriminate.

In late 2007, the finished fake cards were shipped to an Upper Deck warehouse in North Las Vegas and later given to sub-distributors, including one named Vintage Sports Cards in Conroe, Texas. Vintage then repackaged the rare cards with other Yu-Gi-Oh cards that it couldn't sell.

The repackaged product contained three packs of cards laid side by side on a cardboard backing and covered in clear plastic. On top of each pack was the rare counterfeit card as an enticement for buyers to purchase the entire package. It contained a total of 26 cards and carried a price of just \$6.99.

As the cards worked their way into stores, Upper Deck officials started to question whether the scheme would work.

In April 2008, McWilliam called a meeting in his office to compare the Chinese cards to genuine Yu-Gi-Oh cards. According to court depositions, McWilliam yelled at several executives about discrepancies. He spoke on the phone at one point and instructed the person, "Remember, you do not know where you got the cards from, OK?" McWilliam shredded the genuine and counterfeit cards in his office when the meeting ended.

"They were skillful fakes, but distinguishable to people who know the cards," said Fox, the attorney for Konami.

Eventually, Vintage put some of its repackaged cards in Toys "R" Us stores, where in August 2008 they were discovered by a Konami employee. Konami officials said the cards also made their way into Kmart and Wal-Mart stores.

At first, Konami sued Vintage, but Vintage quickly showed it had obtained the cards from the authorized distributor, Upper Deck. In October 2008, Konami filed suit against Upper Deck and two months later terminated their distribution agreement.

In all, about 611,000 counterfeit cards were printed but more than one-third of them were recovered by a Konami private investigator in October 2008 before they could be repackaged for sale, according to court filings.

Costs of piracy

The discovery of product piracy by a distribution partner resulted in immediate changes at Konami.

Digital card files are no longer shared with vendors or other business partners. More importantly, the company now handles its own distribution, an expensive and complicated process.

Kenny So, owner of comic book and card shop Comic Odyssey in Pasadena, had heard vague rumors about a legal battle brewing over Yu-Gi-Oh, but he didn't pay attention until the surprise announcement in December 2008 that Konami would distribute its own cards. Soon after, the supply of Yu-Gi-Oh cards stopped.

"There was a transition period after Konami took over its distribution because they weren't experienced in that," So said. "Everything is good now that Konami is in full control. They have been incredibly good at store support and in releasing products on time."

So believes some of the bogus cards might have turned up on his shelves, but isn't sure.

"I could have sold a few because they were hard to tell – they were really good counterfeits," he said.

One of the oddities of the case is that while piracy by business partners and others is considered a growing problem worldwide, usually Asian companies are accused of it – not American.

But George Haley, director of the Center for International Industry Competitiveness at the University of New Haven in Connecticut, said piracy is a growing problem for all.

"You have to monitor partners and double-check every transaction," he said. "It drives up the cost of business and lowers the willingness of people to make investments."

Meanwhile, Konami appears to have put the case largely behind it. But that is not necessarily so at Upper Deck, given the loss of its MLB contract, according to trading card expert Williams.

He said that as far back as the 1990s, if an Upper Deck baseball card proved valuable, the company would simply print more of them. Technically, printing extra cards wasn't illegal but it angered collectors who counted on the rarity of a card to determine its value.

"This is a company that essentially had a license to print money legally, and yet it was never enough for them," Williams said. "There is a precedent for this type of behavior."

Upper Deck declined to comment on Williams' statements.

Los Angeles Business Journal, Copyright © 2010, All Rights Reserved.