



# new matter

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# The Crime of the Century:<sup>1</sup> the Exploding Problem of Counterfeit Goods, and What Can Be Done



C. DENNIS LOOMIS  
*Baker & Hostetler LLP*

*The following is based upon the presentation made by the author at the IP Institute, at Dana Point, CA, on November 13, 2009.*

## IS DEALING IN COUNTERFEIT GOODS REALLY WRONG?

FOR MOST PEOPLE, it is obviously wrong to shoplift a DVD movie or a CD recording, or to steal a pair of shoes. This is not a morally complex dilemma. But for many of the same people, the question of “right or wrong” becomes murky when it comes to downloading a bootlegged copy of a hit song on the Internet, or buying an obviously counterfeit Rolex watch or Gucci handbag.<sup>2</sup> Here, there are “extenuating circumstances.” This isn’t really “stealing.” Nobody is really hurt. After all, the band and the record company are already rich, one more download doesn’t really matter. They should be happy I’m listening to their music. Or: I would never pay thousands of dollars for an overpriced wristwatch or a purse, so Rolex and Gucci are never go-

ing to see my money in any event. Buying a pretty good look-alike for \$20 impresses my friends and doesn’t cost them anything. And besides, this poor guy selling stuff on a blanket on the sidewalk—and the folks in some faraway factory who make these knock-offs—probably need the money.

Beyond any particular rationalizations, many folks, particularly those who have grown up with the Internet, have a basic belief that if something is available online for downloading, it *should* be free. How can something so easy to do, and so commonly done, be wrong? And once you’re comfortable with the idea of “taking” a free electronic copy of someone else’s creative effort, “taking” the equally intangible value of another’s famous brand by purchasing counterfeit products may seem less problematic as well.

The very concept of “intellectual property” is itself somewhat nebulous for the layman (and even some lawyers), which contributes significantly to the prevailing moral ambiguity about intellectual property theft. If I take your coat, or your car, or your money, we all understand intuitively that that is wrong. It’s your “thing,” and now I have it, you don’t. But if I make an unauthorized electronic copy of your musical recording, what have I really “taken”? You still have the original recording, you can still make and sell your own copies. Similarly, if I buy that fake Rolex, what have I taken *from Rolex*? They didn’t make the actual watch that I bought, and they are free to make and sell as many genuine Rolex watches as they can find customers to buy. So where’s the problem?

This article will try to answer that question. Dealing in counterfeit goods is most definitely wrong, legally as well as morally. It costs legitimate businesses hundreds of billions of dollars in lost profits. It deprives local, state and federal governments of more billions in uncollected sales, income and business taxes. It directly generates and supports child labor and other sweatshop labor abuses around the world. It exposes the public to substandard, potentially defective and dangerous products, including pharmaceuticals, electronics, toys and many other categories. The profits—and they are huge—support organized crime<sup>3</sup> as well as global terrorist organizations.<sup>4</sup>

In a perverse way, the pervasive ambivalence about whether intellectual property piracy is really wrong, translates to less risk and more profit for the counterfeiters. It helps maintain a steady customer base for low priced (or free) counterfeit products. It leads many law enforcement agencies and officers to view piracy as a “victimless crime” not worthy of serious enforcement or punishment. In this author’s opinion, it also tends to contribute to a general blurring and erosion of commonly held standards of right and wrong in the society at large.

## THE SCOPE OF THE PROBLEM

It has been estimated that the overall losses suffered by legitimate businesses as a direct consequence of counterfeit product manufacturing, distribution and sales, including lost profits and costs of rights enforcement, exceeds \$500 billion a year, and is growing. The same well informed source estimates that 7% to 10% of all products in the marketplace are counterfeit.<sup>5</sup>

A formal study conducted by the Los Angeles County Economic Development Corporation in 2007 estimated that the overall economic losses suffered from counterfeiting



by Los Angeles area firms whose products are significantly pirated exceeded \$5.2 billion dollars in 2005, and resulted in the loss of 106,000 jobs.<sup>6</sup>

We can reasonably assume the situation has grown worse in the meantime. The United States Customs and Border Patrol reports that the number of counterfeit seizures at the Port of Los Angeles increased by 29% between 2006 and 2007, and that the value of counterfeit imports seized nationwide increased 38% from 2007 to 2008.

The problem is growing around the world. And counterfeit personal care products and pharmaceuticals, exposing consumers to a significant risk of personal injury, are a particularly alarming growth area. The European Commission reported in 2007 that seizures of counterfeit products inbound to the EU increased in 2006 by 330%, to 250 million counterfeit articles seized. Seizures of cosmetics and other personal care products increased 128% in that same period.<sup>7</sup> Worldwide seizures of counterfeit pharmaceutical and over-the-counter drugs increased 24% in 2007, with seizures occurring in 99 countries, encompassing over \$3 billion worth of bogus products, including generic copies that violate patent laws and products that lack active chemical ingredients or improper dosage.<sup>8</sup>

The most important single phenomenon contributing to the global growth of counterfeiting is, clearly, the Internet. The ability to advertise and sell products more or less anonymously online, coupled with the explosive expansion of online retail auction and “personal listings” sites such as eBay and Craig’s List, have eliminated any significant barriers to entry for any aspiring counterfeiter. Further assisting the counterfeit seller, the Internet buyer has no opportunity to actually examine the offered goods before committing to purchase. In contrast to a “brick and mortar” transaction, a consumer who desires only to purchase genuine branded products will rarely discover that products offered online are counterfeit before it is too late to walk away.

Once the counterfeit product arrives, the ability of the consumer to obtain redress from the actual seller is doubtful at best. The same is true of the reach of law enforcement to locate and prosecute such wrongdoers. With only a URL and a website user account (if that) as the trail to follow, and with the real person or persons behind the scam often in a different state, or a different country from the victim, it is a daunting challenge to track one of these culprits down. Conversely, it is relatively simple for the counterfeiter to set up shop at a new web address whenever the old location is identified as illegitimate.

In a further perverse irony, the Internet not only makes it easier and less risky to sell counterfeits, it also makes it more profitable. The sidewalk vendor has no choice but to sell his obvious fakes for a low price. As a practical matter, therefore, it is less likely that the genuine brand owner will lose a sale to a brick and mortar counterfeit seller.

But online, no such purchaser due diligence is possible. Indeed, in order to play out the deception, the Internet counterfeiter is motivated to price his bogus products close enough to the genuine article to avoid flagging their phony pedigree. Further, the counterfeiter can readily copy and display genuine advertising images and product information from the brand owner’s online site, lending the counterfeit web offering an appearance of authenticity that the consumer will not easily penetrate. So the cheap knock-off that might only fetch \$20 or \$30 at a swap meet, can potentially be sold online for just a modest discount off the manufacturer’s suggested retail price. This means that the online pirate’s profit margin may be many multiples greater than his brick-and-mortar counterpart.

Internet selling also significantly reduces seller overhead costs, like rent, inventory, sales staff, utilities, sales tax reporting, etc. So an enterprising counterfeiter can actually make a profit by purchasing the counterfeit goods in small lots, often delivered from the foreign counterfeit manufacturer by air freight (much harder for Customs to identify

and intercept), as needed to fill customer orders.

As noted above, another important fuel for the counterfeit explosion is the ambivalent attitude among police, prosecutors and judges about the seriousness of the crime. If you sell crack, you go to jail. If you sell counterfeit shoes, DVDs, or whatever, you are more likely to suffer only a small fine and a suspended jail sentence. And yet the profit margin on the crack is probably not much more—and possibly even less—than the margin on the counterfeit goods.

This asymmetry has not escaped the notice of the bad guys. While product counterfeiting is not replacing drug dealing, car theft and other serious crimes, the drug dealers, gang bangers and other felons who favor those crimes have most definitely added significant counterfeiting to their preferred criminal activities.

But there are promising signs that the tide may be changing. Local, state and national legislators, prosecutors and judges have, in the past several years, come to better understand the evil and the multi-faceted social harm that flows from counterfeiting. Harsher laws, stiffer penalties and a focused effort to educate and inform the public have been the result. More on this subject is discussed below.

## WHAT CAN BE DONE?

There are many resources and tools available to a brand owner seeking to limit the impact of counterfeiting on its bottom line and on the integrity and good will associated with its brand. On the enforcement side, there are state and federal statutes (and some local ordinances) that create substantial criminal and civil liability for the counterfeiter, but it is neither easy nor inexpensive to deal with this problem. The brand owner needs: (1) an understanding of the problem and the available remedies, (2) a well informed internal team tasked with managing the problem, (3) familiarity with the outside resources to aid in the



fight, and (4) a plan of action that reasonably balances the harm caused by the counterfeiting and the resources the company can prudently allocate to its anti-counterfeiting efforts.

### The Protection Team

The key players are:

- ▶▶ Senior corporate management;
- ▶▶ In house counsel;
- ▶▶ Outside counsel;
- ▶▶ Federal law enforcement (Customs and Border Patrol (CBP), Immigrations and Customs Enforcement (ICE)); and
- ▶▶ Specialty service providers who monitor infringing online sales and auctions for the brand owner, send take-down notices to the Internet Service Provider, locate and send cease and desist notices to identified counterfeit sellers, and other internet monitoring and enforcement services.

### Protection Tools

- ▶▶ Federal criminal statutes;
- ▶▶ State criminal statutes;
- ▶▶ Civil statutes; and
- ▶▶ CBP/ICE enforcement.

## BASIC ELEMENTS OF A BRAND ENFORCEMENT STRATEGY

There are several core components that will typically be included in an effective enforcement strategy. These include:

***Register, record and renew your trademarks and other intellectual property assets (e.g., copyrights, patents).***

In addition to the numerous other benefits of having a federally registered mark (which are beyond the scope of this article), registration of your trademark or service mark with the United States Patent and Trademark Office (USPTO) is an essential precondition to invoking many of the available aggravated civil penalties, and all of the available criminal remedies against the counterfeiter. Once registered, the mark owner must be alert to timely observe all renewal requirements to keep the registration in effect.<sup>9</sup>

Similarly, in order to have the benefits of CBP enforcement of your trademark and copyrights, including CBP seizure of apparently counterfeit imports, refusal of entry to confusingly similar goods, and imposition of civil fines, the brand owner must first record its trademark registrations and copyright registrations with the CBP.<sup>10</sup>

The benefits of invoking CBP enforcement are self-evident: The CBP does the work, at no direct cost to the rights owner. While border enforcement is far from sufficient, standing alone, to stop all unlawful importation of counterfeit goods, it is nevertheless a valuable and very cost-effective tool.

***Train your team, and have identification materials ready.***

New manufacturing, printing and industrial design technologies make it easier and cheaper for counterfeit manufacturers to produce much higher quality fakes that can be

harder to discriminate from the genuine article. It follows that any in house personnel with responsibility for the company's brand protection efforts, as well as outside counsel, private investigators and involved law enforcement and CBP personnel, should be trained in how to reliably identify a counterfeit.

Beyond that core group, a company may want to share this information with as many of its employees and interested service providers as practicable, so that they will be able to recognize and report counterfeits for sale when encountered in their day-to-day activities. A company may want to consider a "reward" program for tips about suspected counterfeit sales that lead to successful prosecution or other action.<sup>11</sup> The more eyes and ears on the lookout for counterfeit products, the better.

The company should also assemble a kit with easy-to-understand instructions and tips for positively identifying counterfeits, and have these kits ready for distribution to investigators, attorneys, law enforcement and CBP as needed.

***Prepare management for the costs of enforcement, and consider strategic alliances.***

The civil remedies available against a counterfeiter are very robust. Among other things, the law provides for issuance of a no-notice order to seize and impound all counterfeit goods;<sup>12</sup> imposition of treble damages for knowing counterfeiting;<sup>13</sup> alternatively, statutory damages of as much as \$2 million for each counterfeit mark;<sup>14</sup> and recovery of the successful plaintiff's attorneys' fees in "exceptional cases."<sup>15</sup>

But these remedies come at a significant cost. The requirements of pleading and proof to secure a no-notice seizure order at the outset of the lawsuit are rigorous and detailed, and correspondingly, involve considerable attorney effort by a counselor who is well informed in this area of the law. And once the order is issued, the plaintiff will be exposed to additional third party



charges to carry it out that can be even larger than the lawyer's bill. These include: location security, often involving off duty law enforcement officers and licensed investigators; "bagging and tagging" the seized goods, critically important to uphold the legitimacy of the seizure; transportation and storage of the seized goods; and the cost of a security bond that the court will almost invariably require the plaintiff to post as a precondition to the seizure, to compensate the defendant for losses suffered if the seizure order turns out to have been improvidently granted.

And these are just the costs that can be expected in the first 30 to 60 days after filing the complaint and the seizure motion. After that, the costs of prosecuting the case to a final verdict or other resolution, while highly variable, will be even more considerable.

Therefore, it is wise to review these potential litigation costs with management and to assess the company's ability and willingness to absorb these costs before that "hot tip" arrives that may support legal action. In that event, rapid action may be imperative (for example, if it is feared that the counterfeiter, or the inventory of counterfeit goods, may "disappear" in short order if not promptly seized). It will be best if the company has thought carefully through the various possible scenarios before action is required, and developed the necessary contingency plan, so it can pull the trigger quickly if it so decides.

The very significant costs of civil counterfeiting enforcement support another strategy, namely, developing strategic alliances with other companies who are similarly affected by counterfeiting activity and who may be willing to proceed jointly, on a cost shared basis, against counterfeiters who are knocking off both companies' products. For example, the swap meets, discount bazaars, sidewalk vendors and web sites that offer counterfeits of one apparel manufacturer, will most often offer counterfeits from many competing and

related manufacturers (e.g., counterfeit fashion accessories, jewelry and cosmetics will often be sold alongside counterfeit apparel). In such a case, the various companies, even direct competitors, may decide that it is in their best interests to share the costs to file a single lawsuit, naming each company as a plaintiff, and seeking a seizure order that authorizes impounding of all counterfeits bearing any of the plaintiff brands that are found during the single seizure raid.

*Seek the assistance of local, state and federal law enforcement authorities to investigate and criminally prosecute counterfeiting.*

Willfully manufacturing, distributing, importing and selling counterfeit articles is a serious criminal offense under federal law and also the laws of most states and many local communities. But in most cases, the intellectual property rights owner must at least bring the suspected infringer to the attention of law enforcement, and present some credible evidence that the suspect is actually engaging in criminal activity, in order to have an investigation and eventual prosecution initiated.

Nevertheless, the costs for private investigators, counterfeit purchases and other information that must be assembled to present a credible criminal complaint to law enforcement will typically be only a small fraction of the costs to initiate and pursue a private civil action. And the imposition of criminal penalties will often act as a much more effective deterrent on the counterfeiter than entry of a civil judgment awarding damages.

## ASSERTING THIRD PARTY LIABILITY

One of the factors that make the economics of civil enforcement action by brand owners so problematic, is that in many cases, the actual counterfeit sellers who are sued and whose goods are seized are either judgment proof, or simply default and disappear upon service of the complaint.

This underscores the desirability of being able to assert liability against the third parties who support and sustain the counterfeiters' activities, and who often will have identifiable assets and much less ability to disappear in the night. These notably include landlords, swap meet producers, and Internet Service Providers.

The applicable legal theories are contributory and vicarious liability. Briefly stated, the former may exist when the third party defendant does not control the direct infringer, but knowingly assists or provides the means for the infringement. The latter attaches where the direct infringer is an agent or business partner of the third party and shares in the illegal profits.<sup>16</sup>

Expanding on the desirability of attaching liability to third parties who support or knowingly profit from counterfeiting, New York City<sup>17</sup> and, more recently, Los Angeles,<sup>18</sup> have passed local ordinances that impose significant liability on landlords for the unlawful activity of their tenants after notice. These cities have also mounted significant public education programs and educational outreach to judges and police, to highlight the serious harm of the crime of counterfeiting and to encourage consumers to avoid counterfeits, and to prompt the police and the bench to treat counterfeiting as the great evil and enormous economic injury that it is.

## CONCLUSION

Product counterfeiting, as has been shown, is a deadly serious economic and social problem, and the numbers indicate that the problem is growing. However, with the two largest cities in America, New York and Los Angeles, having identified the problem and



implemented statutes and public education campaigns that enhance and expand the ability of rights owners and law enforcement to attack and punish the problem with the severity it deserves, we may be reaching a turning point. Hopefully the emerging focus on effectively combating product piracy will turn the trend line down in the foreseeable future.

In the meantime, companies and entrepreneurs whose success and profitability turns on protecting and enforcing their intellectual property rights, owe it to themselves to become educated about the problem of counterfeiting and the available solutions, and then to develop an intelligent and balanced plan to work towards that goal. ◀◀

*The views expressed in this article are personal to the author and do not necessarily reflect the views of the author's firm, the State Bar of California, or any colleagues, organization, or client.*

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*C. Dennis Loomis is a partner and the Coordinator for the Intellectual Property, Media and Technology practice in the Los Angeles office of Baker & Hostetler LLP. His practice focuses on litigation, transactional, and rights registration services involving trademarks, copyrights, trade secrets, rights of privacy and publicity, ecommerce, and licensing agreements, among other matters. He has represented the Motion Picture Association of America, major motion picture studios, leading apparel and fashion companies and many other brand owners in regional, national and international anti-piracy enforcement programs.*

#### Endnotes

1. This is how James Moody, former Chief of the FBI's Organized Crime/Drug Operations Division, has characterized the problem of counterfeiting.
2. "Counterfeiting" refers to manufacturing or distributing a product or service bearing a trademark or service mark that is identical to or substantially indistinguishable from a registered mark.
3. See *Congressional Testimony, Federal Bureau of Investigation, FBI.GOV* (Oct. 30, 2003; accessed Jan. 11, 2010) <<http://www.fbi.gov/congress/congress03/ashley103003.htm>>.
4. See Kathleen Millar, *Financing Terror: Profits from Counterfeit Goods Pay for Attacks*, U.S. Customs TODAY, Nov. 2002, available at <http://www.cbp.gov/xp/CustomsToday/2002/November/interpol.xml> (accessed February 10, 2010).
5. These statistics were included in a presentation by Mr. Kris Buckner at the California State Bar Association's "34<sup>th</sup> Annual Intellectual Property Institute" on November 13, 2009. Mr. Buckner is the founder and President of Investigative Consultants, a leading private investigation agency specializing in intellectual property crime investigations and prosecutions. He is one of the most experienced and highly regarded experts in America in this field, having personally directed thousands of investigations regarding the manufacturing, smuggling, distribution and sales of pirated goods. He has also trained thousands of prosecutors and law enforcement professionals charged with investigating and prosecuting intellectual property crimes. Mr. Buckner was joined on a panel presentation entitled "It Takes a Thief: War Stories from the Anti-Counterfeiting Trenches" by this author, and by Ms. Deborah Greaves, Secretary and General Counsel of True Religion Jeans, a publicly traded premium apparel company. The author acknowledges and extends his thanks to Ms. Greaves and Mr. Buckner for their many expert insights that have informed this article.
6. See Los Angeles County Economic Development Corporation, *A False Bargain: The Los Angeles County Economic Consequences of Counterfeit Products* (Feb. 2007; accessed Jan. 19, 2010) <[http://www.laedc.org/reports/consulting/2007\\_piracy-study.pdf](http://www.laedc.org/reports/consulting/2007_piracy-study.pdf)>.
7. See Ahmed El Amin and Louise Prance, *Cosmetic and Personal Care Counterfeit Seizures Increase*, *Cosmetics-Design-Europe.com* (June 5, 2007; accessed Jan. 11, 2010) <<http://www.cosmeticsdesign-europe.com/Products-Markets/Cosmetic-and-personal-care-counterfeit-seizures-increase>>.
8. Allen Dodds, *Fake Viagra Leads 24% Jump in Seizures of Counterfeit Medicine*, *Livemint.com* (June 10, 2008; accessed Jan. 11, 2010) <<http://www.livemint.com/2008/06/10231936/Fake-Viagra-leads-24-jump-in.html>>.
9. Basically, an Affidavit of Continuing Use of a registration must be filed with the USPTO between the fifth and sixth anniversary of the registration date, and the registration must be renewed between the ninth and tenth year after issuance, and every ten years thereafter.
10. 15 U.S.C. § 1124(2002); 19 C.F.R. § 133.31 (1987).
11. Many will have heard the commercials widely broadcast by the Business Software Alliance, a trade group that aggressively recruits employees to "blow the whistle" on their software-copying bosses, with up to a \$1 million reward for successful tipsters.
12. 15 U.S.C. § 1116 (2008).
13. 15 U.S.C. § 1117 (2008).
14. 15 U.S.C. § 1117(c) (2008).
15. 15 U.S.C. § 1117 (a) (2008).
16. The following are leading cases articulating the theory and application of contributory and vicarious infringement liability: *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844 (1982); *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996); *Hard Rock Cafe Licensing Corp. v. Concession Services, Inc.*, 955 F.2d 1143 (7th Cir. 1992); *Arista Records, Inc. v. Flea World, Inc.*, 2006 U.S. Dist. WL 842883 (D.N.J. Mar. 31, 2006); *UMG Recordings, Inc. v. Sinnott*, 300 F. Supp. 2d 993 (E.D. Cal. 2004).
17. N.Y. Real Prop. Law § 231 (McKinney 2009).
18. Los Angeles, Ca, Municipal Code § 41.72 (2010).