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The Fake and the Fatal: The Consequences of Counterfeits

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The Fake and the Fatal

Intellectual property is every bit as important as physical property. For many corporations, intangible assets like brands and trademarks are even more valuable than tangible assets (Hopkins, 2003). For example, the Coca-Cola brand name is far more valuable than the ingredients that go into a can of Coca-Cola (Hopkins, 2003). Businesses expend a great deal of time, energy, and resources to protect their ideas, brands, and identities from counterfeiters and intellectual property infringers. Firms do this not only to preserve their reputations and profitability, but also to prevent the consumer from unknowingly purchasing unsafe, low-quality goods from unscrupulous dealers. A substantial number of governments have enacted laws and treaties that protect legitimate holders of intellectual property and punish infringers in order to protect their citizens and local industries from those who would attempt to usurp the brand names of successful companies.

Despite these attempts to defend intellectual property rights, however, counterfeiting remains rife. Counterfeit goods cost the American economy as much as $250 billion a year, and counterfeiting is responsible for the loss of over 750,000 American jobs (U.S. Chamber of Commerce, www.thetruecosts.org; Federal Bureau of Investigation). Trade in counterfeit goods may account for as much as 7% of all world trade, and some have estimated that one out of every hundred pharmaceuticals in the United States is counterfeit (Teresko, 2008; Congressional Hearing 11/1/05). Almost any product can be and has been counterfeited, including baby formula, electrical equipment, fuel, designer goods, guitars, airplane parts, and birth control pills. The damage is more than just economic; the shoddy quality of counterfeit goods has led to deaths, illnesses, and injuries. For instance, a woman named Maxine Blount unknowingly consumed counterfeit pharmaceuticals which contributed to her death (Congressional Hearing, 11/1/05). Because trade in counterfeits typically involves illegal black market transactions at some point along the distribution chain, the burgeoning counterfeit industry has resulted in lost tax revenue, an absence of regulatory control, and an environment where terrorists and members of organized crime syndicates can fund illicit and deadly activities through counterfeit operations.

This paper will describe the current global counterfeiting problem, trace its origins, illustrate its negative effects on American citizens, businesses, and governments, and suggest steps that stakeholders can take in order to decrease the incidence of counterfeiting and its impact on the United States.

What is Counterfeiting?

Counterfeit goods are non-genuine goods "that copy or otherwise purport to be those of the trademark owner whose mark has been unlawfully used" (Mallor, 2007). Counterfeits may or may not be of lesser quality than the genuine goods, and they may or may not be convincing replicas of the copied good. As David Hopkins, Lewis Kontnik, and Mark Turnage

describe in their book *Counterfeiting Exposed: Protecting Your Brand and Customers*, counterfeits may vary quite a bit with regard to quality and deceptiveness (2003). Therefore, a broad range of goods can accurately be classified as counterfeits. If a peddler on the street offers you an obviously fake pirated version of the latest blockbuster movie for a paltry sum of cash, that peddler is offering you a counterfeit. If a factory in China is officially licensed to manufacture a specific quantity of brand name appliances, and if that factory produces unauthorized overruns that are identical to the licensed goods, that factory has manufactured counterfeits. If unscrupulous dealers misappropriate a batch of genuine pharmaceuticals, heavily dilute the drugs, and then repackage them and sell them as legitimate medicines, they are dealing in counterfeits. As long as a person creates or sells a non-genuine good in an attempt to "usurp the brand or trademark of another," that person is guilty of counterfeiting (Hopkins, 2003).

Although "gray market" illegally diverted goods are not counterfeits per se, they have been called the "handmaidens" of counterfeit goods because counterfeiters often seed shipments of gray market goods with counterfeits to boost their profit margins (Hopkins, 2003; *No Trade in Fakes,* 2006; Lewis). The illicit distribution channels through which gray marketing occurs are clandestine and unregulated, and therefore quite conducive to the trafficking of counterfeit goods. Thus, even though gray market goods and counterfeits are not synonymous, the two may nonetheless be frequently found together (*No Trade in Fakes,* 2006).

The Lay of the Land

Almost any product can be counterfeited. No product is too simple or too complicated to counterfeit, as long as the illegal profit margin is attractive enough. Even "soap has been counterfeited for profit by unscrupulous counterfeiters, as have the most basic office supplies" (Hopkins, 2003). On the other end of the spectrum, "the most sophisticated pharmaceuticals and electronics" have also been counterfeited.

Counterfeits are not only available in black markets where law-abiding consumers would never find them, or from seedy merchants at shady street corners. They have been found in almost every type of legitimate retail location, "including large chain department stores, hotel gift shops, upscale boutiques, swap meets," and "flea markets" (Congressional Hearing, 5/25/05). For instance, in one case, a customer who had unknowingly bought counterfeit and ineffective pharmaceuticals "purchased her drugs at one of the largest and most reliable pharmacies in St. Louis" (Congressional Hearing, 11/1/05).

Moreover, the problem appears to be getting worse. Twenty six years ago, "the International Trade Commission estimated losses from counterfeiting and piracy at $5.5 billion" (*White Paper,* 2005). Just six years later, "losses were estimated at $60 billion." Eight years after that, "damage to the United States economy" alone "was estimated at $200 billion" (*White Paper,* 2005). Even taking increased enforcement and inflation into account, these figures are extremely unsettling.

Troubling Tales

Outrageous stories about dastardly counterfeiting schemes abound. Sharing a few of them compellingly illustrates the breadth and gravity of the problem and shows how far remorseless counterfeiters are willing to go to turn a profit. Each reinforces the fact that counterfeiting unjustly impacts innocent businesses and consumers, and that steps must be taken to prevent its occurrence.

Pfizer, the New York-based pharmaceutical company that manufactures the anti-inflammatory drug Ponstan, discovered that its product had been the target of Colombian counterfeiters who sought to illegally profit off of the intellectual property of several successful American corporations (Hopkins, 2003). These counterfeiters had set up shop in several "dilapidated houses" in "a poor neighborhood of Bogotá," where they produced counterfeit Ponstan tablets in a non-sterile environment. The pills they manufactured were nearly indistinguishable from the genuine product, yet contained little more than "boric acid, floor wax, and yellow highway paint." These materials are highly toxic to humans.

In 1999, the FDA issued a warning "regarding counterfeit cans of infant formula" which could cause "fevers, skin rashes or severe allergic reactions" (*Facts on Fakes,* 2007). "Some of the illicit product had already been purchased" before the warning reached consumers. Similarly, a personal care products manufacturer once hired a private investigator upon discovering that some of its products were being counterfeited. The investigator successfully procured evidence that counterfeiters were manufacturing fake baby shampoo. No parents would want their young infant anywhere near this shampoo, which "had a bacterial count higher than human feces" (Hopkins, 2003).

Horrifyingly, sub-standard counterfeit parts have turned up in "helicopters sold to NATO, in jet

engines, bridge joints, and fasteners in areas of nuclear facilities responsible for preventing the meltdown of the reactor itself" (*Facts on Fakes,* 2007). Similarly, Delta Airlines discovered that the engine mount cone-bolt which fastened the engine to "one of its planes was actually counterfeit" (*Facts on Fakes,* 2007). It is impossible to tell what devastating consequences could have occurred had these fake parts not been discovered. Worse, it is also near impossible to tell how many undetected counterfeit parts are currently installed in crucial applications across the country.

Tragically, counterfeit products have led to deaths, such as that of Maxine Blount. Ms. Blount, a Missouri resident diagnosed with breast cancer in 1998, was prescribed Procrit by her doctor in order that she could "build her blood, strength and stamina" between rounds of chemotherapy treatment (Congressional Hearing, 11/1/05). At first, the medicine had been quite effective, and Maxine Blount was able to receive regular treatments which kept the cancer in check and allowed Ms. Blount to enjoy her life. However, the Procrit suddenly stopped working in 2002, and Ms. Blount's condition worsened (Congressional Hearing, 11/1/05). As a result of her flagging health, Ms. Blount "had to lengthen the time between treatments," which allowed "the cancer to advance more rapidly." Ms. Blount assumed that her cancer had simply advanced so far that the Procrit could no longer do anything for her, but her nurse was suspicious (Congressional Hearing, 11/1/05). The nurse took the medication to a laboratory for analysis. The lab results indicated that the drug was in fact counterfeit, and had only five percent of the active ingredient that Ms. Blount needed to remain healthy (Congressional Hearing, 11/1/05). The counterfeit Procrit prevented Ms. Blount from rebuilding her strength, thus rendering her unable to "take the chemo treatments as needed" (Congressional Hearing, 11/1/05). As a result, her cancer advanced and her health deteriorated rapidly. Maxine Blount died on October 24, 2002.

Maxine Blount did not purchase her Procrit from a disreputable online pharmacy, a black market vendor, a foreign country with an absence of strict regulatory controls, or on the street. The drug reportedly came from a legitimate, reputable, large pharmacy chain in the United States (Congressional Hearing, 11/1/05). Ms. Blount had absolutely no idea that the product she was buying was counterfeit, or that the drugs she carried home from her trusted pharmacy would ultimately contribute to her death. Furthermore, it is possible that even the pharmacy had no idea that the drugs were counterfeit. Distribution chains can be so labyrinthine in the pharmaceutical industry that counterfeits occasionally enter the supply chain without the knowledge of the manufacturers or end consumers. According to Katherine Eban, author of the book *Dangerous Doses,* "adulterated medicine routinely lands on our pharmacy shelves in part because major wholesalers seek out discounted medicine from smaller ones" (Congressional Hearing, 11/1/05). If just one small wholesaler engages in illicit trade with counterfeiters, then the safety of the entire drug distribution system can be compromised. An investigation of Ms. Blount's medication eventually traced the counterfeit Procrit back to one cheap vendor; it is possible that subsequent wholesalers passed the fake drugs along the links of the chain with little or no inkling that they were trafficking in counterfeit pharmaceuticals (Congressional Hearing, 11/1/05).

Thankfully, some recent reforms have repaired weak links in the pharmaceutical supply chain. Many legitimate distributors and pharmacies no longer purchase drugs from the secondary market or from other distributors who deal in the secondary market (Congressional Hearing, 11/1/05). However, "loopholes remain," even in the highly regulated pharmaceutical market. Every supply chain, regardless of the industry, has weaknesses, and counterfeiters prey on those weaknesses to insert illegitimate goods into the legitimate market (*No Trade in Fakes,* 2006).

The previous story indicates that counterfeiters "care little about the potential devastating consequences of their illicit actions," or, as will be described later in this paper in the section on terrorism and organized crime, actually "intend such devastating consequences" to innocent businesses and consumers (*White Paper,* 2005). The problem cuts across disparate industries, from pharmaceuticals to air transportation to consumer electronics to food. Stories like this alert us that the lay of the land, when it comes to counterfeiting, can be quite frightening.

Why is there such a large problem?

Counterfeiting is so prevalent in part because it is extremely lucrative. Unscrupulous merchants can generate staggering profits from counterfeiting operations. For example, one counterfeit t-shirt ring "generated millions of dollars" before it was busted by the FBI (*Facts on Fakes,* 2007). Hopkins, Kontnik, and Turnage estimate that "the 'brand premium,' the difference between the price of the branded good and its generic counterpart, is a rough measure of the profit margin available to the counterfeiters" (2003). For many successful products, this brand premium can be extremely large. If counterfeiters utilize shoddy materials and low quality standards when

manufacturing fake goods, this profit margin may be even higher.

The advent of low-cost technology has also contributed to the increased prevalence of counterfeiting (Hopkins, 2003). Counterfeiters now have access to inexpensive tools like photographic-quality computer scanners and digital printers which allow counterfeiters to easily replicate logos and create convincing-looking packaging. Internet access also makes it easy for counterfeiters to market to potential customers, misappropriate intellectual property, and forge links with other counterfeiters. Sophisticated counterfeiting operations therefore require minimal initial investment or technical prowess.

Furthermore, the risks to counterfeiters are generally small. "Legal penalties for counterfeiting are low in most countries," and do not exist at all in others (Hopkins, 2003). Many who are caught trafficking in counterfeit goods in the United States only receive probation for their crimes (Congressional Hearing, 5/25/05). According to the president of a licensed investigative firm in California, one suspect they were tracking had to be arrested six times for counterfeiting before serving any jail time whatsoever (Congressional Hearing, 5/25/05). Although IP enforcement is very strong in the United States compared to other countries, law enforcement officials sometimes perceive counterfeiting as significantly less important than violent crimes and crimes against physical property, even though the economic damage and health risks can sometimes be just as compelling (Congressional Hearing, 5/25/05). Moreover, counterfeiting is relatively easy to get away with. Manufacturers and distributors of counterfeit goods can conduct their illicit business while remaining "relatively anonymous," and "without leaving a paper trail" (*White Paper,* 2005).

The existence of situations where demand for certain goods vastly exceeds supply also encourages counterfeiting (World Health Organization, 1999). Counterfeiters can satisfy this demand by selling cheap fakes. For instance, so many people want certain designer handbags that customers at the bottom of the waiting list won't receive their handbag for several years. In this case, counterfeiters who offer a reasonable facsimile without the wait can receive both praise and profits from handbag-happy customers. The same is true for drugs that are available by prescription only. Those who wish to misuse medicines like muscle-enhancing steroids or pills for erectile dysfunction, yet do not have a diagnosis requiring the use of such medications, often seek these pharmaceuticals in the black or gray markets. This demand has generated a thriving international market for counterfeit lifestyle drugs (World Health Organization, 1999).

Increased globalization is another culprit that has led to a greater number of counterfeit goods in the marketplace. Although globalization has been advantageous to the global economy and has greatly expedited legitimate international trade, it has also "increased the ease of distribution" of counterfeit products, as well as "the incentive to counterfeit" (Hopkins, 2003). When there is "more trade flowing across borders," "it is also easier for counterfeit products to flow" between countries, and new opportunities are created for counterfeiters to "maximize their return on investment and minimize their costs" (Hopkins, 2003). A counterfeit product that infringes on the trademarks of an American company can be manufactured in Asia, packaged in the Middle East, and sold in the United Kingdom in no more than a few weeks. All of this can occur outside the American company's awareness, due to the surreptitious and global nature of the illicit trade, and the freedom with which such trade can be conducted in the global marketplace.

Globalization has also strained the resources of U.S. Customs (Hopkins, 2003). The more goods cross U.S. borders, the harder customs officials have to work to prevent counterfeits from entering the legitimate supply chain. Due to booming international trade, customs officials must inspect an overwhelming quantity of goods in a relatively short time period. This further increases the chances of counterfeits infiltrating the U.S. economy from abroad.

Several countries have become notorious for rampant intellectual property violations. These foreign markets include China, Russia, India, Brazil, Indonesia, Vietnam, Taiwan, Pakistan, Turkey and Ukraine (Teresko, 2008). In these countries, brand names, patents, trademarks, and copyrights are regularly infringed by manufacturers and dealers who traffic in large quantities of counterfeit goods. The governments of these countries frequently do not go far enough to police the counterfeiting problem, and in some cases the local government is actually directly or indirectly encouraging the production and sale of counterfeits to increase employment or capitalize off the success of American businesses (Phillips, 2005). Along that same vein, "some developing nations believe that technology should be transferred freely to foster their economic growth. Consequently, they either encourage" counterfeiting and piracy "or choose not to oppose it" (Mallor, 2007).

Of the countries listed above, China is by far the worst offender. U.S. Customs reported that over 80%

of all counterfeit goods seized by Customs in 2006 originated in China (Blanchard, 2007). Chinese counterfeits often infringe on the intellectual property rights of American businesses, and can pose health risks for American consumers.

Many Chinese counterfeits reach American shores due in part to China's newfound membership in the World Trade Organization (Phillips, 2005). In order to join the WTO in 2001 and thus remove barriers to trade, China, which already had a substantial economy of counterfeits within its own borders, was required to strengthen its statutes against counterfeiting. Unfortunately, the new legislation, which is extremely strict on paper, is not rigorously enforced by the central government. Simply enacting laws has not resolved the issue. As a result, China is now a member of the WTO, and thus enjoys substantial opportunities for international trade, but the counterfeits that are knowingly produced within Chinese borders can be disseminated relatively freely across the globe.

It must be noted that Chinese authorities have taken some measures to appease Western governments and mitigate the counterfeiting problem, particularly in the period directly preceding the 2008 Olympics. Many raids of suspected counterfeiters have been authorized and carried out by the Chinese government. Regardless, counterfeits still abound in China. Counterfeiting operations that are raided are often back in business a day later because counterfeiters make certain to never be caught with enough counterfeit merchandise to invite severe civil or criminal prosecution (Lewis). Moreover, pressure to eliminate counterfeiting often conflicts with the Communist government's obligation to maximize the employment level. As Li Guorong of the China United Intellectual Property Protection Center explains, "Sometimes the factory" that produces counterfeits "is the largest single employer in the province, so if there is a raid the local mayor might call the police and tell them not to proceed" (Phillips, 2005). To further compound the problem, many Chinese businesses that produce and store counterfeits are owned by local military and political officials (Phillips, 2005). The counterfeit trade is so lucrative in China that the government could adversely affect the economy were it to completely eliminate the practice. Direct conflicts of interest such as these make the elimination of Chinese counterfeits extremely difficult.

Globalization, both in China and elsewhere, further aggravates the counterfeiting problem due to the increasing prevalence of outsourced manufacturing. Many American companies have licensed their intellectual property to foreign companies, which pay for the right to manufacture a certain quantity of genuine brand-name goods. There is nothing inherently wrong with this practice as long as the manufacturer only assembles the quantity of goods that it is licensed to produce, and that the goods comply with the exacting standards of the parent company. However, as author Tim Phillips points out, "if you own a factory and you are licensed to make 100,000 mobile phone batteries, it's tempting to make 150,000, using extra materials that you bought for yourself, and hide the extra 50,000 when the inspectors from the company that employs you come to call" (2005). Since the inspectors never see these products, the foreign manufacturer has no incentive to ensure that they meet stringent product quality standards, and in fact the manufacturer may be able to realize higher profits if such standards are ignored. Therefore, some foreign companies are often the source of both counterfeit products and the genuine article.

These problems with outsourced manufacturing have led to a phenomenon commonly known as the "ghost shift." This occurs when manufacturers are only licensed to run for "two eight-hour shifts," but "the factory runs for 24 hours, with an unofficial extra shift using cheap materials, unofficial labor and safety shortcuts" (Phillips, 2005). The manufacturer can then sell these unauthorized counterfeit products for substantial profits, without having to pay the licensing fees to the parent company.

Oftentimes, counterfeiting goes unchecked because many people perceive counterfeiting as a "Robin Hood" sort of crime. Many Americans resent large, successful corporations, particularly those that charge high prices for goods they view as unnecessary luxuries, such as manufacturers or distributors of designer goods. These consumers are not sympathetic when multinational corporations are victimized by counterfeiters, especially when the consumers are unaware of the overarching economic and social damage caused by counterfeiting or the links between counterfeit operations and organized crime. In fact, in some circles it is now considered chic to own counterfeit merchandise, such as faux designer handbags (Phillips, 2005). Abroad, counterfeiters are often viewed as saviors who provide the downtrodden with opportunities for jobs and revenue in countries with growing unemployment problems (Hopkins, 2003). Anti-American sentiment also contributes to an "us versus them" mentality and reinforces the notion that counterfeiting steals from the rich and gives to the poor. This resistance to anti-counterfeiting efforts, both here and abroad, further exacerbates the problem.

All of the factors described above create an environment where counterfeiters can thrive, with little fear of detection or retaliation, and in some locations, with the imprimatur of the public or the government.

The Consequences of Counterfeiting

As evidenced above, counterfeits pose a significant risk to consumers. Unsafe fake goods can lead to injuries, deaths, and illnesses, as the cases of Maxine Blount illustrates. In cases where fake goods cause no physical harm, consumers are harmed financially when they are hoodwinked into spending their hard-earned cash on a poor-functioning, low-quality counterfeit. Moreover, since businesses must raise their prices to recoup losses from counterfeiting, the public is "forced to pay higher prices for brand-name products because of counterfeiters" (Congressional Hearing, 5/25/05).

However, the threat that counterfeits pose to Americans extends far beyond the shoddy quality of the products themselves and higher prices for genuine goods. Criminal counterfeiting operations often fund the activities of groups who seek to kill innocent citizens. According to the Secretary General of Interpol, "intellectual property crime is becoming the preferred method of funding for a number of terrorist groups," including, but not limited to, Hezbollah and al Qaeda (Congressional Hearing, 5/25/05). Likewise, Russian, Eurasian, Asian, and Lebanese organized crime groups profit from intellectual property crimes, and "there may be a trend developing for local gang involvement in" counterfeiting (Congressional Hearing, 5/25/05).

Although the secretive nature of terrorist and organized crime groups makes it almost impossible to precisely determine the extent to which these organizations are involved in counterfeiting, evidence strongly suggests that counterfeiting funds terrorist and criminal activity. Seized al Qaeda training manuals advise recruits to engage in "the sale of fake goods as one means to raise funds" (*Facts on Fakes,* 2007). In 1996, the FBI found that followers of Sheik Omar Abdel Rahman, a "blind cleric who was sentenced to 240 years in prison for plotting to bomb New York City landmarks," had made millions of dollars selling counterfeit t-shirts bearing Nike and Olympics logos (*Facts on Fakes,* 2007). A Vietnamese crime gang leader earned $13 million selling counterfeit watches in New York (Hopkins, 2003). Counterfeiting has been used as a tool to launder drug money (*Facts on Fakes*, 2007). Furthermore, counterfeiting is not only an opportunity for unsavory groups to generate funds, but also could be used as a method of attack. Terrorists could flood a legitimate market, such as the pharmaceutical trade, with deadly counterfeit goods to harm innocent Americans, create panic, destabilize the economy, and undermine confidence in the United States government. Manufacturers and distributors of counterfeits have also been known to utilize violence against persons and property to resist the anti-counterfeiting efforts of law enforcement, private investigators, or other American citizens, even counterfeiters that are not linked to organized crime or terrorist groups (Congressional Hearing, 5/25/05; *White Paper,* 2005).

Counterfeiting poses threats to legitimate businesses as well. By counterfeiting a company's product, that counterfeiter becomes a competitor of that legitimate company. As a result, that company loses sales and market share. Making matters worse, the counterfeiter has an unfair advantage, since it has not had to pay for R&D costs or brand development. Therefore, counterfeiters leech profits from American businesses in ways that no legitimate competitor can. As mentioned previously, counterfeiting costs the U.S. economy as much as $250 billion a year (U.S. Chamber of Commerce, www.thetruecosts.org; Federal Bureau of Investigation).

Counterfeiters also erode the value of the brands they counterfeit. As low-quality, inexpensive fakes flood the market, and as more and more customers are deceived by bogus goods, the market demand, and thus the market price of a particular brand, declines substantially (Hopkins, 2003). Hopkins, Kontnik, and Turnage explain that customers who inadvertently purchase counterfeit goods "will conclude that the brand has not delivered on its promise" upon discovering that the product is a fake, and thus attach less value to a particular brand. As intellectual property represents roughly 45 to 75 percent of the value of many Fortune 500 companies, this loss of brand equity is particularly painful for genuine businesses (Phillips, 2005). If that frustrated consumer stops purchasing that brand's products altogether, the business not only loses brand equity but all future revenues that customer would otherwise provide (Phillips, 2005).

Moreover, the prevalence of counterfeit goods in the marketplace results in a higher number of warranty claims. When low-quality counterfeits fail, unknowing purchasers complain to the legitimate producer. These consumers are not satisfied upon learning that the product is bogus, because "consumers feel that it is the company's responsibility to prevent counterfeits, and if the company can't do this, then they feel the company should service the fake product anyway" (Hopkins, 2003). This presents businesses with a dilemma; they can refuse to service

or replace the fake, or they can provide the owner of the counterfeit with a genuine product or an equivalent sum of cash. If they refuse to service the counterfeit, the customer may become infuriated and complain to his or her friends and family. The business thus stands to lose future profits from not only the purchaser of the counterfeit, but other prospective customers as well. However, if the business gives in and replaces the product, it has not only lost the initial sale to the counterfeiters, it has also unfairly surrendered its inventory or money to appease the angry consumer. Either way, the legitimate producer loses.

Businesses who are victims of counterfeiting may also incur losses in the form of legal liability. If a consumer buys a counterfeit product thinking it to be genuine, and is injured by that product, "the brand holder may still face liability damages, and almost certainly will face legal costs in attempting to isolate themselves from responsibility" for the injury (Hopkins, 2003). According to Arthur Best of the University of Denver Sturm College of Law, "tort law would be likely to support a victim's claim against a producer of legitimate goods if harm from a counterfeit product 'was foreseeable, the enterprise had a role in creating the risk of crime, and it failed to take reasonable steps to reduce that risk'" (Hopkins 2003). That is, even if a legitimate business is not dealing with counterfeiters and has no knowledge of any illicit activity, that business could still be slapped with monetary damages for failing to implement sufficient anti-counterfeiting and authentication measures.

Counterfeiting harms not only individual consumers and businesses, but also the United States as a whole. The trade of counterfeit goods is clandestine in nature, and transactions frequently occur off the books. Therefore, the United States government cannot collect taxes off of counterfeiters' sales and profits. Were it not for the presence of counterfeit goods in the marketplace, consumers would buy goods from taxable, legitimate businesses. Counterfeiters thus deprive the government of tax revenues, leaving less money to fund schools, hospitals, roads, parks, fire and police forces, and other desirable public amenities (*White Paper*, 2005).

The existence of counterfeiting also serves as a disincentive to innovation. Because counterfeiters don't have to "recoup research and development costs" incurred in inventing new products or processes, counterfeiters "can enter the market with a similar product in less than 2 percent of the time and less than 1/1000 of the cost" (Hopkins, 2003). In the presence of widespread counterfeiting, innovators have a minimal incentive to expend the effort and resources necessary to produce beneficial new technologies, because counterfeiters can profitably misappropriate these new ideas and make it increasingly difficult for innovators to recover their expenses. Moreover, the prevalence of counterfeiting has forced businesses to divert R&D resources away from creating new technologies and into methods to deter counterfeiters. Respondents to a study conducted by the Organization for Economic Cooperation and Development "spent over half their R&D investment on anti-piracy technologies and product differentiation" as a response to the increasing incidence of counterfeiting in the global economy (Teresko, 2008). In this way, counterfeiting impedes technological progress, discourages economic growth, and hinders improvement of the standard of living in the United States.

These are just a few of the reasons why counterfeiting hurts society; this list is by no means exhaustive. The myriad negative consequences of counterfeiting described above illustrate the need to take proactive steps to combat this growing epidemic.

What needs to be done?

Unfortunately, individual businesses cannot solve the problem on their own, nor can individual consumers, or even individual governments. Cooperation between these entities at a global, not just national, level is crucial for stemming counterfeiting and its ill effects. Consumers, businesses, trade associations, regulatory agencies, local and national law enforcement, the federal government, and foreign governments must all work together to fight a common enemy.

What can businesses do?

Firms must utilize a multi-faceted approach to discourage counterfeiters and protect their consumers, profits, and legal rights. Businesses have many tools at their disposal, such as supply chain management, legal action, product identification technologies, and cooperation with interested parties. A successful anti-counterfeiting strategy will incorporate several of these tools, as well as quantitative methods for monitoring the progress of the strategy.

Almost any company can become the victim of counterfeiters at any time, because "counterfeiters prey on weaknesses in the legitimate supply chain" (*No Trade in Fakes,* 2006). Therefore, every firm must secure its channels of distribution from counterfeiters, regardless of whether or not the firm is aware of any past or current counterfeiting activity.

By instituting safeguards that make it difficult for counterfeiters to interfere with the supply chain, businesses create strong preventive measures that deter intellectual property thieves.

The U.S. Chamber of Commerce has compiled a list of "Supply Chain Best Practices" that businesses can follow to deter counterfeiting (*No Trade in Fakes,* 2006). For instance, firms must be certain to properly dispose of surplus, damaged, or otherwise unusable products. "Individuals engaged in counterfeit trade often prey on scrap yards, waste repositories, or reclamation centers to obtain inferior goods discarded by the brand owner," so it is crucial for businesses to prevent their waste from entering the legitimate distribution chain (*No Trade in Fakes,* 2006). Thus, companies should "institute policies to certify that production waste and damaged and unusable products are destroyed" in such a manner that would preclude their use by counterfeiters (*No Trade in Fakes,* 2006). Likewise, if businesses donate surplus goods or goods that could be used safely despite falling below established quality standards, they should "select one or two trusted charities [...] to ensure that goods are not [...] blended back into the legitimate supply chain" (*No Trade in Fakes*, 2006). Failure to implement these policies could compromise the integrity of a business's distribution network.

Similarly, brand owners should "only sell to legitimate distributors or retailer outfits" (*No Trade in Fakes,* 2006). Manufacturers and wholesalers must vigilantly check the credentials of other companies with which they do business, and avoid dealing with disreputable firms or those that have been known to sell counterfeits. Counterfeiters frequently "pose as legitimate businesses" and purchase legitimate products in large quantities to "blend fake products" with real ones, and thus "maximize returns" and "launder resources" (*No Trade in Fakes*, 2006). The U.S. Chamber of Commerce recommends that companies train their sales force to be wary of, and avoid transactions with, shady establishments. If customers attempt to order "an unusually large volume for normal needs," are "willing to pay cash for very expensive orders," and offer vague delivery dates "planned for out-of-the-way destinations," the sales team has good reason to be apprehensive (*No Trade in Fakes,* 2006).

Businesses may also want to consider the benefits and drawbacks of disintermediation. A greater number of middlemen in a given supply chain increases the risk of that distribution chain being compromised. It may be possible for some companies to decrease their exposure to counterfeiting by eliminating or consolidating unnecessary intermediaries in the distribution channel.

Companies should also regularly perform surprise audits and inspections on members of the distribution chain to ensure compliance. For example, a parent company could visit authorized foreign manufacturers to make sure they are not engaged in "ghost shift" manufacturing. To be effective, these audits have to come without warning. Otherwise, counterfeiters could simply hide or destroy the evidence, and continue their illicit operations once the inspectors have left. If executed correctly, however, inspections like these can catch counterfeiters red-handed. These audits have a deterrent effect as well; if other entities have no idea if and when inspectors will arrive, they may be less likely to engage in counterfeiting in the first place.

Businesses can also utilize "mystery shopping" techniques to gather random samples of products in various markets and test their authenticity (*No Trade in Fakes,* 2006). By monitoring the goods available for sale from retailers, web sites, and online auctions, companies can not only prevent counterfeit goods from reaching the hands of consumers, but also use the information they gather to determine the source of counterfeit goods, as well as which geographic areas have the highest proportion of counterfeit goods.

Businesses can also take steps to inform the consumer of ways to identify genuine and counterfeit goods. For example, some luxury good and pharmaceutical manufacturers have posted tips for spotting fakes on their web sites (Hopkins, 2003). Educating the consumer can reduce the chance of consumers being deceived by bogus goods.

To aid in the easy detection of counterfeit products, businesses can also incorporate revolutionary authentication and product differentiation technologies into their packaging. These technologies, although expensive to adopt, are also expensive to counterfeit. Thus, these techniques not only provide a disincentive to counterfeiting, they also make it far easier for investigators, consumers, regulatory agencies, and customs officials to determine whether or not a product is counterfeit.

All of the aforementioned strategies can help prevent counterfeiting before it occurs, and thus save time and resources. However, sometimes preventive measures are not enough, and legal recourse becomes necessary. Businesses can enlist the help of law enforcement to apprehend and convict counterfeiters under criminal statutes, and they can resort to civil litigation. Several statutes with varying purposes and

scopes can help American businesses curb counterfeiting.

One of the most important pieces of legislation that litigators can use against counterfeiters within the United States is the Lanham Act. Among other things, the Lanham Act allows for tort claims against those who infringe a company's trademarks or imitate a business's trademarks, trade names, packages, and labels (Mallor, 2007). Since counterfeiters utilize "false representations that are likely to induce third parties to believe that the defendant's goods or services are those of the plaintiff," they are subject to civil liability if their activity falls under the jurisdiction of the United States (Mallor, 2007). According to Brian Lewis, a partner at the Chicago-based law firm Wildman, Harrold, Allen & Dixon LLP, the Lanham Act can also occasionally be utilized against international offenders due to its "broad jurisdictional requirements;" a person or company that violates an American mark outside of the U.S. can sometimes be sued in the United States. Recent changes in the Lanham Act that allow ex parte seizures have further increased the statute's efficacy against counterfeiters (Lewis). With the marshal's assistance and the U.S. Attorney's approval, counterfeit products can be seized "without giving notice to the defendant." This capability increases the likelihood of finding important evidence or catching counterfeiters red-handed, narrows the time window of counterfeiters to destroy or hide counterfeit goods, and decreases the likelihood of counterfeits entering the legitimate distribution chain.

The recently passed Prioritizing Resources and Organization for Intellectual Property Act of 2008, also known as the PRO IP Act, has given trademark owners powerful new weapons against counterfeiters (Handler, 2008). Among other things, "the PRO IP Act has doubled the amount of statutory damages available to trademark holders under the Lanham Act," has authorized courts to award statutory damages up to $2 million against counterfeiters, and has enabled trademark holders "to seek treble damages against 'secondary' actors – such as corporate officers – who intentionally assist or aid in the efforts of counterfeiters." The legislation has also established an Executive Branch office called the Intellectual Property Enforcement Coordinator, which will serve to combat copyright and trademark infringement. The PRO IP Act is quite new; time will tell whether it proves an effective measure against counterfeiting.

Many developed countries have their own anti-counterfeiting laws that American businesses can employ against counterfeiters, particularly if a business has already registered its trademarks and patents in that country. For instance, the United Kingdom's 1994 Trade Marks Act and its subsequent refinements serve an analogous purpose to American anti-counterfeiting legislation (Hopkins, 2003).

Not only do many governments have their own intellectual property laws that purport to guarantee some of the rights of certain American businesses, there are also several overarching trade agreements and international treaties that require signatory nations to respect the intellectual property rights of foreign businesses. For instance, members of the World Trade Organization agree to abide by the Agreement on Trade-Related Aspects of Intellectual Property Rights, or TRIPS (Mallor, 2007). TRIPS, among other things, guarantees that "minimum standards of intellectual property protection," such as protection of patents and trademarks, are "provided by each member nation" (Mallor, 2007). Similarly, "the European Union allows a single filing" for a trademark "to be effective in all EU nations." The Madrid Protocol, which the U.S. joined in 2003, "permits a firm to register a trademark in all its signatory nations simultaneously." These multinational trademarks are enforced by the World Intellectual Property Organization.

Unfortunately, as explained previously, many countries do not have their own IP laws in place, or do not enforce them. Some of the countries that have the worst counterfeiting problems have not signed treaties pledging to enforce the IP rights of other countries. Others have signed such agreements but often fail to abide by them. Therefore, relying solely on civil litigation or the application of criminal penalties will not single-handedly solve the problem.

What can consumers do?

Consumers, first of all, need to stop intentionally buying counterfeits. While many consumers buy counterfeits with absolutely no inkling that the goods could be fake, there are many who purposefully seek out and purchase counterfeit goods to save money or, in the case of luxury goods, to appear trendy. These consumers need to be aware that their actions could harm consumers, businesses, and society, and could also encourage organized crime and terrorist activities.

Those who do not seek out counterfeit products must also be wary. Consumers can abide by the old adage when shopping for products; if a price seems too good to be true, it probably is. Unfortunately, even price is no longer a reliable indicator of whether or not a product is counterfeit. As Brian Duggan of the Motor and Equipment Manufacturers Association explains, "One way we used to detect counterfeit

parts was that they were too cheap. Anyone would know something is wrong. So to get around that problem, the counterfeiters simply raised their prices" (Phillips, 2005). Therefore, consumers should not only be wary of extremely inexpensive goods, they should not assume that a reasonable price precludes a counterfeit product.

Consumers should also keep track of the effectiveness and quality of the goods they purchase, and be alert for any inexplicable changes in quality between a recently purchased product and one they have purchased in the past. Low-quality goods should be reported to the genuine manufacturer or an appropriate regulatory agency to determine whether or not they are legitimate. Similarly, the World Health Organization recommends that users of pharmaceuticals report adverse reactions or the sudden loss of a drug's efficacy to their pharmacies or physicians (1999). This vigilance is not only necessary to preserve the safety of the individual using the medication, but also to prevent others from taking counterfeit medications from the same batch or shipment.

Consumers should also avoid purchasing goods from suspicious dealers. If something doesn't seem right about a particular retailer selling brand name goods, consumers are encouraged to inform the producer or law enforcement of their suspicions. Likewise, consumers seeking pharmaceuticals online should be particularly careful. While not all online pharmacies deal in counterfeits, many do, and consumers should be careful.

Concerned consumers can also ask their elected officials to prioritize anti-counterfeiting efforts, and vote for candidates that pledge to be tough on counterfeiters. If the public expresses greater concern about the problem, the government may be willing to employ more resources towards anti-counterfeiting initiatives.

What can authorities do?

First and foremost, American governmental and law enforcement agencies need to step up enforcement of intellectual property laws in the United States (Lewis). It must be noted that the United States government enforces intellectual property rights far more rigorously than almost every other government in the world, but the sheer magnitude of the problem and the alarming rate at which the counterfeit economy is growing require institutions like the Federal Bureau of Investigation and U.S. Immigration and Customs Enforcement to do more to investigate and prosecute the criminals involved in the counterfeiting trade. Many governmental officials are beginning to realize the scope and implications of the counterfeiting issue, but some still need to abandon the notion that counterfeiting is a victimless white-collar crime and thus only of secondary importance to the U.S. government (Congressional Hearing, 5/25/05).

The PRO IP Act is an excellent start, but the government must follow through to ensure that anti-counterfeiting programs are effectively implemented. Along those same lines, Congress should also appropriate more resources to law enforcement and customs. As noted previously, the problem seems to be getting worse, and thus a proportional increase in customs officers and law enforcement agents is needed to successfully catch and prosecute violators of intellectual property rights.

The U.S. government also needs to team up with foreign governments to zealously pursue what Tim Phillips describes as "an international response to an international problem" (2005). Even if the government were to completely stamp out all counterfeit operations within the U.S., if the United States isn't taking a global initiative to cooperate with foreign law enforcement and attempting to standardize laws and penalties regarding counterfeiting, then counterfeiters will just transfer their operations to a more permissive country. Given the international nature of trade, merely shoving counterfeiters across the pond will not preclude unsafe counterfeit products from entering the United States.

The United States must also exert strong political pressure on countries that fail to police counterfeiters within their borders. If other countries refuse to cooperate, the United States, along with bodies that govern international trade like the World Trade Organization, can stipulate specific goals that each foreign nation must meet to avoid economic penalties. For example, a country that is lax in its enforcement of intellectual property rights could be encouraged to reduce the incidence of counterfeiting within its borders by 10% in a given a year. Failure to meet these goals could result in "a variety of trade restrictions such as higher tariffs, lower quotas, and the much more punitive option of an economic embargo" (Hopkins, 2003). Such economic sanctions were used against Ukraine in 2002 in response to widespread intellectual property rights violations, and could be used against other countries as well (Hopkins, 2003). Of course, protectionist economic policies cause economic harm too. American businesses are harmed when they cannot deal with legitimate foreign companies or invest in developing economies. Consumers become unable to purchase certain low-cost imported goods, which can have an

adverse effect on the standard of living in the United States. The presence of economic sanctions also strains relations between nations. Moreover, increased enforcement becomes necessary to make sure that neither Americans nor foreign citizens violate these sanctions. Thus, cost-benefit analyses on a case by case basis would be necessary to determine whether the harm of counterfeiting is outweighed by the harm of enacting economic sanctions. In many cases, the health risks to innocent consumers and the substantial losses to American businesses caused by counterfeiters may be enough to offset the damage that economic penalties might cause. To leave open the possibility of future mutually beneficial trade, and to better encourage nations to enforce intellectual property rights, the application of economic penalties should be rehabilitative in nature, rather than merely punitive.

Conclusion

Although counterfeiting poses significant threats to Americans and the nation's economy, there are many steps that businesses, consumers, and governmental entities can take to make counterfeiting more difficult, more risky, and less profitable. If these entities cooperate, then it is quite possible that their efforts will reduce the global incidence of counterfeiting, make consumers safer, eliminate disincentives to innovation and growth, remove opportunities for unscrupulous criminals to finance deadly activities, and protect the ideas and concepts that form the backbone of our economy. It will not be easy; encouraging enforcement of intellectual property rights will be met with obstacles, as counterfeiters will do anything to protect their livelihoods. Nevertheless, we must fight back, lest counterfeiters fill the world with fakes. We must fight back, and we must fight back now.

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