

How To Counter The Counterfeitors

A Guide to Fighting Back
Against Fake Goods in China



Bob Youill

Senior Managing Director
Forensic & Litigation Consulting
FTI Consulting

Despite significant government efforts, China remains the world's primary source of counterfeit goods. In 2012, the United States seized 22,848 shipments of intellectual property ("IP")-infringing products originating in China. That constituted 84 percent of all seizures made that year, according to U.S. Customs and Border Protection.

Over the same period, the European Commission registered nearly 90,000 seizures of counterfeit goods, again primarily from China. The most commonly seized products were handbags, wallets, watches, jewelry, clothing, consumer electronics, footwear and pharmaceuticals — all fakes.

The sources and distribution channels of counterfeit goods coming out of China are kaleidoscopic. We have found that high-end counterfeiting operations often can be facilitated either by a company's own Chinese joint venture partner (that perhaps is dissatisfied with the terms of its contract) or by sophisticated criminal enterprises with production and logistics capabilities that allow penetration into overseas and local markets. There also are a plethora of small-scale retailers of finished products that are not truly standalone entities but rely upon regular deliveries of counterfeit goods from large, organized suppliers and from Internet-based counterfeiting operations veiled

by B2B and B2C websites. This online flow of counterfeit goods has grown so swiftly over the past few years that experts predict that the online trade of counterfeit goods in China will surpass the physical trade of such goods in the next two or three years. [Effective anti-counterfeiting enforcement, even in a company's home jurisdiction, requires decisive management and the coordination of experts from both inside and outside the company.](#) Doing so in China raises additional issues for legal counsel. For example, for any course to be effective, a brand owner first must have registered its intellectual property with the proper Chinese authorities, but it's not always clear as to which authorities are considered "proper."

Decision makers must understand the costs (as well as the possibilities for success) of various enforcement actions, whether that entails hiring a service provider to identify counterfeit goods for sale on the street or enlisting the government's help in checking for

fakes arriving at ports and catching and prosecuting the criminals. Companies also must consider the risks of taking actions that will require sensitive corporate data to be entered into the public domain.

Above all, business leaders must understand that stopping the production, distribution and sale of counterfeit goods from China never will be easy — although it can be done. There are certain steps that all companies can and should take.

Declare Your Intellectual Property

An effective anti-counterfeiting strategy for China begins with registering the relevant intellectual property rights in China, as China does not automatically recognize IP rights registered overseas or in Hong Kong. Even if a trademark is registered under the Berne Convention for the Protection of Literary and Artistic Works, Chinese authorities may

be reluctant to assist in enforcing an infringement claim.

There are several government agencies in China where registration can take place:

Trademarks

The Trademark Office, part of the State Administration for Industry and Commerce ("SAIC"), registers brand names and trademarks. Trademarks also should be registered with the General Administration of Customs ("GAC") to facilitate inspection and the seizure of counterfeit goods at ports.

Patents

The State Intellectual Property Office ("SIPO") registers patents (other than artwork).

Copyright

The Copyright Protection Center of China ("CPCC"), which is affiliated with the National Copyright Administration ("NCA"), registers copyrights. Software registration should be filed with the CPCC. Other copyrighted works also can be registered with the CPCC and the NCA's branches at the provincial or municipal level.

Because of how critical registration is to enforcement, the volume of registrations handled by these bodies is growing. According to the World International Property Organization, SIPO accounted for more than 70 percent of the worldwide increase in patent applications between 2010 and 2012. Indeed, more patents, trademarks and designs were registered in China in 2012 than in any other country in the world.

When it comes to anti-counterfeiting actions, registration is much more than a check-the-box exercise. As a general rule, if a trademark, patent or design has not been registered in China with the proper agency, any anti-counterfeiting program, no matter how sophisticated, will come to naught, as there is very little chance that Chinese enforcement agencies would be willing to conduct raids or prosecutions.

Quantify the Risk to Your Brand

Counterfeit goods erode brand value and can hinder a company's attempts to grow in new markets. Once aware that goods are being counterfeited in China, in-house counsel first should consider the company's brand protection strategy.

In-house counsel should work with key stakeholders to review the company's markets inside and outside China (the goal of large-scale, organized counterfeiting inside China often is to export product) and then organize those markets into three segments:

1. Key markets that must be protected from counterfeit goods.
2. New markets the company is considering entering that must be protected from infiltration by counterfeits.
3. Less important markets and/or those that have been lost to counterfeitors.

Questions counsel should ask:

1. Is the problem counterfeiting alone or does it involve grey market activities and other issues related to customs, tax or regulatory concerns?
2. What individuals and/or which organizations are the primary cause of the problem? Is it one major offender or several smaller wrongdoers working independently or together?



Building Your Anti-counterfeit Team

The primary responsibility for managing counterfeiting will rest most of the time with in-house counsel and will involve representatives from different corporate functions, as well as outside consultants and legal counsel. A typical team should include:

Team head: Usually the regional in-house counsel who will be responsible for providing overall strategic guidance

Chief point of contact for investigators:
Generally a regional security director

Public relations lead: Coordinating strategic messaging either with in-house or external PR

Legal coordination: China in-house counsel

External consultants: Including international counsel, local counsel and investigative firms

Internal stakeholders: Manufacturing, sales and marketing, government relations, public relations and other relevant corporate resources on the ground in China.

Internal stakeholders commonly have detailed insight into the counterfeiting arena and can help in abating the problem. For instance, product heads can comment knowledgeably on the quality of the counterfeits and the resources needed to produce them; sales and marketing personnel can analyze the distribution channels and the competitive impact of the counterfeits; and government relations specialists will have a sense of the appetite for pursuing action by the various Chinese enforcement agencies in the regions in question.

3. Is the problem limited to China or are other countries and regions affected as well?
4. Are there identifiable patterns and trends that can be seen and addressed?
5. How long will it take before the problem represents a serious threat to the company's profitability and brand reputation?

Unfortunately, too many times a counterfeiting problem is recognized as truly serious only after several actions have failed to resolve it. A sophisticated anti-counterfeiting program, therefore, should start with a detailed review of all past enforcement actions (both successful and unsuccessful) to identify any valuable intelligence that either has gone undiscovered or has been forgotten. In-house counsel's role is to present as full a picture as possible for the investigative team (including outside consultants and external counsel) of what the rights owner has done in the past. Counsel needs to gain cooperation from all players, including internal security personnel who may see the outside consultants as interlopers and/or threats.

Once this preliminary stage is complete, the business will be in a position to determine the goals and objectives of any anti-counterfeiting action and to calculate what level of resources will need to be allocated.

Pick Your Best Course of Action

Counterfeiting in China frequently is conducted (or facilitated) by large, sophisticated networks. Accordingly, it is most cost-effective first to discover where goods accumulate (for example, with packaging and assembly providers) and then develop a hit list of offenders. This allows the rights owner to conduct higher impact enforcement actions rather than multiple, smaller scale raids on individual vendors. This is not only more effectual, but it also reduces the burden

that enforcement places on corporate resources, including those associated with running the program.

When considering tackling organized counterfeiting operations, the first target (if only to eliminate the possibility — but this is where large-scale counterfeiting operations often begin) should be any joint venture or other commercial partner on the ground in China, as well as the local senior management team. This should be done discreetly.

If such an investigation does not reveal any suspicious behavior, the organization will require a more substantive response than simply raiding vendors. The most effective approach is to initiate administrative, civil or criminal proceedings against the major players in the counterfeiting supply chain. This requires that the rights owner conduct its own investigation to build a case that can be passed on to enforcement authorities.

The following is a list of the usual anti-counterfeiting actions and the consequent management considerations for each:

Street Sweep

The most common type of enforcement action in China — and typically the first response to a counterfeiting problem — is the street sweep: raids and seizures conducted by a variety of local service providers. These providers vary in size and sophistication, from simple one-man operations to larger companies that have a string of investigators posted around the country. These entities specialize in conducting one-off enforcement actions. Nearly all operate by providing raid targets for a fee.

These actions potentially can yield valuable information about counterfeiting supply chains. However, these local service providers generally are reluctant to share intelligence. They seize vendors and goods, but that's usually all they do. Consequently, unless a rights owner has its own in-house intelligence management system, a significant amount of valuable information can

remain undiscovered.

Customs Watch

A rights owner that has registered a trademark properly in China may apply to a customs official at the GAC to seize suspected counterfeit goods during a port inspection. In a customs watch, a rights owner is required to pay a bond to cover any losses attributable to wrongful seizure. Applications for a customs watch must include evidence of intellectual property ownership, licenses to do business in China, details of original goods (such as price, port of entry, authorized importers and exporters, and packaging details) and information about counterfeit goods.

Local practices in carrying out a custom watch vary, and, therefore, it is important to engage local counsel to get the details of how custom watches are conducted in any particular area.

A rights owner also must be prepared to react quickly to any customs official's request for seized product verification. Any failure to respond expeditiously could result in the suspect counterfeit goods being shipped or, worse, making a customs official reluctant to take action in the future.

Administrative Action

Sanctions are often taken on behalf of a rights owner that has registered intellectual property properly. A rights owner can seek remedies and damages against manufacturers, distributors and vendors through administrative bodies.

In general, an administrative sanction is easier to execute and quicker to resolve than a civil or criminal proceeding and avoids some of the risks that come with judicial action, including disclosure requests for sensitive information and anti-bribery and anti-corruption concerns surrounding providing payments for enforcement costs.

Unfortunately, the deterrent value of administrative sanctions is limited. Many counterfeiters regard such penalties as a

cost of doing business, nothing more.

Civil proceeding

This process investigates elements of the counterfeit supply chain and typically is more time consuming than an administrative action but gives rise to a wider set of remedies. In general, the process can involve a rights holder that gathers evidence of counterfeiting and issues a cease-and-desist letter registered with a civil authority. This may lead to a criminal court proceeding and a negotiated settlement.

Criminal Proceeding

This process is the greatest deterrent to and disruptor of counterfeiting activities. This course of action is available only for infringement activities that meet certain thresholds related to the quantity and value of goods involved and the severity of the case; e.g., whether it is politically sensitive; encompasses widespread, syndicated activity; or applies to goods that could harm the public such as counterfeit drugs. These cases are handled by the local Economic Crimes Unit of the Public Security Bureau ("PSB").

Although criminal enforcement often offers the most satisfying solution to counterfeiting claims, there are several practical challenges along this path that companies should consider. For instance, the interpretation of case thresholds varies depending on the province or municipality in which the action is brought. Some authorities will accept the infringer's assessment of the value of the goods seized as dispositive; some officials may not take into account peripheral evidence indicating the scale of counterfeiting. These conditions can lead to perverse results. For example, if a raid yields packaging for 2 million units, an authority may consider only the value of those goods seized on that production line at that specific point in time.

However, if a credible case can be made that the counterfeiting is serious, a criminal proceeding usually is the best approach. Examples of serious cases include counterfeiting food, drugs or

What You Should Expect of Your External Investigator

If a brand owner does not have a qualified in-house investigator, it will be critical to engage an external one. The investigator's role should include:



Retrieving, collating and analyzing information acquired from past investigations and raids (such as the forensic examination and recovery of computers) and establishing a database to identify the associated entities.



Coordinating the rights owner's distribution networks and offices around China to use as intelligence collection assets.



Providing software and training that can support the intelligence analysis process to discern relationships, distribution processes and fund flows.



Identifying high-worth targets such as suppliers, distributors and buyers, as well as analyzing shipping data to pinpoint offshore buyers.



Advising on the impact of the offenders on the client's business.



Managing tactical actions (for example, coordinating with law enforcement on raids).



Developing a strategy for coordinating actions among fellow industry participants (both for domestic Chinese corporations and for foreign firms).



Monitoring law enforcement to ensure that seized counterfeit products do not find their way back to the marketplace.



Providing litigation support in the prosecution of major offenders.



Responding in a timely manner to law enforcement requests for assistance and documents.

alcohol (with their potential impact on public health) or counterfeiting auto parts (such as brakes, which constitute a public safety threat). The food and beverage industries are the subject of particularly intense official scrutiny due to high-profile incidents such as the counterfeiting of the well-known high-end Chinese spirit Moutai in 2007.

How to Work with the Authorities

Handing over materials to Chinese authorities begins another phase of a company's anti-counterfeiting program. There are a number of risks to manage such as controlling sensitive corporate

information, fulfilling government requests for documents, overseeing internal reporting and complying with reporting rules. Multinational corporations in China often find it helpful to have both international and local counsel collaborating on a case to manage these risks.

Once an action begins in concert with Chinese authorities, counsel's key concerns should be:

Controlling Sensitive Material

This involves determining what documents will be entered into the public domain for trial. For example, PSB investigators commonly gather evidence at the China offices of the rights owner. This can result in the exposure of confidential information. PSB officials will not acknowledge the authority of foreign lawyers so counsel should ensure that local counsel is on-site and has a clear understanding of what information needs to be kept confidential.

Managing Document Flow

Administrative and criminal actions require the government team investigating the infringement to report back regularly and to submit relevant documents (for instance, PSB investigations normally are conducted on a 30-day reporting cycle). Ensuring that notarized copies of important documents such as incorporation certificates and business licenses are available to investigators when requested can minimize the chance that officials will conduct fishing expeditions. Keep several notarized copies of selected files on hand, as different government bodies many times will require the same documents. Such information should

not be provided to government officials unless counsel first has confirmed that these documents are safe to release.

Overseeing Internal Reporting

International counsel frequently is involved in overseeing and coordinating the local law firm partner to meet with the administrative or PSB investigators at various stages to confirm the progress of the case, conduct oversight and monitoring, and assist authorities with any information needed that the client can provide.

Complying With Reporting Rules

Ensure that the official investigation does not create issues under applicable anti-bribery or anti-corruption law. For example, it is common practice for PSB officers to require that a rights owner pay for incidental and travel costs of the investigators. Fulfilling a request of this kind need not breach applicable law (e.g., the U.S. Foreign Corrupt Practices Act, the UK Bribery Act and applicable Chinese law), but it is important to fully document all interactions with investigators to limit the company's exposure.

If companies follow these practices when going after counterfeiters in China, an organization stands a better chance of success and certainly can avoid making matters worse.

A version of [this article](#) originally appeared on the Practical Law China website.

This article may not be reproduced or redistributed without the prior written permission of Thomson Reuters, including by framing or similar means. If you would like permission to use this article or any other content published on any Practical Law website, please contact info.practicallaw@thomsonreuters.com.

Stories from FTI Consulting's Anti-counterfeiting Files

You can tell a fake drug by its package

FTI Consulting was engaged by a global pharmaceutical company to identify and develop evidence against Chinese entities producing and selling a counterfeit cervical cancer treatment drug. After obtaining several samples of the counterfeit drug from a variety of sources, FTI Consulting conducted a microscopic forensic examination of the packaging and discovered that each package contained the same microscopic non-random defects. This made it possible to identify the factory printing the boxes. Subsequently, the drug counterfeiting ringleaders were sentenced to 12 years' imprisonment.

The inside job

FTI Consulting represented a multinational personal hygiene products firm that had set up many joint ventures in China. The business was being eroded by counterfeiting. Upon investigation, it became clear that the heads of the local joint ventures — dissatisfied with their relationship with the multinational — were responsible for organizing the counterfeiting, aided by local senior managers, vendors and suppliers. With this evidence in hand, the company was able to stop the counterfeiting.



Bob Youill

Senior Managing Director
Forensic & Litigation Consulting
FTI Consulting
Robert.Youill@fticonsulting.com

For more information and an online version of this article, visit ftjournal.com.