

## **Don't Underestimate The Harm Caused By Counterfeiters**

*Law360, New York (September 19, 2013, 6:27 PM ET)* -- In the July/August 2013 issue of Foreign Affairs, Kal Raustiala and Christopher Sprigman argued in their article, "Fake It Till you Make It," that "American anxiety and anger over Chinese piracy are misplaced." They claimed that "Washington's heavy-handed approach to Beijing's copycat culture is too blunt and reflects a simplistic view of innovation."

Although Raustiala and Sprigman certainly argue their position competently, the article severely understates the harms caused by Chinese "copying" generally and by the counterfeiting industry in particular. It is estimated that 70 percent of all counterfeits seized globally come from China, and that from 2008 to 2010, 87 percent of the value of counterfeits seized originated in China.

As an initial matter, counterfeiting threatens the health and safety of both U.S. and Chinese consumers by exposing them to untested and sometimes even dangerous imitation pharmaceutical and food products. For instance, in 2007-2008, counterfeit baby food caused the death or serious injury of thousands of infants in China, and counterfeit pet food killed and sickened thousands of dogs and cats in the United States, after Chinese counterfeiters intentionally mixed melamine, an industrial chemical, with wheat flour to artificially increase protein readings.

In one of the most egregious examples (discussed in a New York Times report), an unlicensed Chinese chemical plant sold diethylene glycol, a chemical used in brake fluid, that was falsely certified as glycerin. It was mixed into cold medicine in Panama, killing more than 100 people and disabling dozens more, usually by kidney failure.

Moreover, even counterfeit products that are not used on or in the body can cause serious injury. About 470,000 counterfeit smartphone batteries were recalled in 2010 because they overheated, causing burn and fire hazards, as detailed by the U.S. Consumer Product Safety Commission. Some counterfeiters have even tried to sell counterfeit electrical parts to the U.S. military, putting our national security at risk. A 2011 congressional investigation found about 1,800 cases of suspect counterfeit electronics being sold to the Pentagon "for several weapons systems, including military aircraft such as the Air Force's C-17 and the Marine Corps' CH-46 helicopter," as documented by CBS News. These do not appear to be simple anecdotal aberrations.

The fashion industry, moreover, is not immune to these concerns. For example, in cases that Gibson Dunn has handled, we have seen jewelry that is labeled as “sterling silver” when it was in fact nickel, a known allergen that is a controlled metal in Europe precisely because of its harm to the consuming public. CNBC has reported on other risks that counterfeit luxury goods such as designer clothing and bags can pose to the public, since they are not held to the same safety standard as authentic designer goods, and are sometimes manufactured using toxic chemicals. And because the counterfeiting industry is rife with fraud, consumers who purchase counterfeit products on the Internet run a substantially higher risk of identity theft.

Counterfeiting also harms U.S. interests by absorbing local, state and federal government resources for an industry that generally does not result in commercial interactions that generate tax revenues or otherwise contribute to U.S. economic development. For example, the International Criminal Court last year reported that the cost of lost tax revenue and additional spending due to counterfeit goods was \$125 billion in developed countries alone. And reports introduced into the Congressional Record indicate that counterfeiting costs U.S. businesses between \$200 and \$250 billion every year and results in 750,000 lost jobs.

Another dire consequence of counterfeiting in general is that it often leads to practices akin to human trafficking. According to the United Nations Office on Drugs and Crime, “[t]here have been many documented cases of illegal immigrants being forced into counterfeit distribution by the migrant smugglers.” The pattern that emerges is similar to that which occurs in cases of human trafficking for sexual exploitation: “The debt incurred by the migrant is so great that they cannot resist demands from their sponsor to engage in illicit work, and the activity becomes tantamount to human trafficking.”

Some of Raustiala and Sprigman’s arguments, moreover, are of dubious empirical value. For example, they argue that purchases of counterfeit goods often lead to purchases of the genuine goods. A 2007 Organization for Economic Cooperation and Development report, however, indicates that precisely the opposite is true: Counterfeit goods diminish the reputation of the copied brand, put downward pressure on prices, and lower the market share of the rights holder. Many consumers, moreover, purchase counterfeits mistakenly believing they are purchasing the genuine product and when something goes wrong with the product or it does not fulfill expectations, they blame the genuine rights holder, resulting in a loss of consumer goodwill. One study concluded that counterfeiting may reduce the sale of genuine products by as much as \$50 billion.

Furthermore, fashion companies invest great resources in many designs that do not end up being profitable, in the hopes that some subset will be popular enough to justify the risk of their investment across the board. If those designs that are ultimately successful are exploited by counterfeiters, brands will have less incentive to invest the time and money in developing their original designs in the first place. As designer Tracy Reese was quoted saying, “[W]e’ve spent a lot of time and money in development and we’re not a big company, and we need to get the benefit of our work before it goes to the broad, mainstream public for \$29.99.”

Finally, there is reason to believe that Chinese counterfeiters may actually harm Chinese citizens in ways that Raustiala and Sprigman overlook. For example, as one UN agency reported, “[e]ven as the major brands work to improve labour standards and workplace safety at their outsourced manufacturing sites, counterfeit goods producers take advantage of global sweatshops.” The culture of fraud and theft that is inherent in counterfeiting may even be undermining the development of China’s legal system by rewarding actors with little or no respect for international legal norms. By enforcing international intellectual property rights, in contrast, China may hasten its own long-term economic development process.

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