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## THE MAGNITUDE AND THE ECONOMIC AND SOCIAL CONSEQUENCES OF COUNTERFEITING AND PIRACY

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### I. Introduction

Counterfeiting and piracy are serious offences posing a threat to our society, in that they hamper investment in research and development and creativity, in addition to endangering public health and safety. **1.01**

Before examining the magnitude of counterfeiting and piracy (Part II) and their economic and social consequences (Part III), we need to delineate briefly the main intellectual property rights and their importance for our knowledge-based economy (Section A). For there to be an intellectual property right infringement, there needs to be a valid intellectual property right in the first place. This book will not examine how valid intellectual property rights can be obtained and maintained. However, each national chapter will briefly evoke the scope of protection of the different intellectual property rights. The meaning of the terms ‘counterfeiting’ and ‘piracy’ will also be discussed and distinguished from other forms of intellectual property right infringements (Section B). **1.02**

#### A. Intellectual property rights and their importance in a knowledge-based economy

Intellectual property rights are exclusive rights enabling right-holders, including creators, businesses, or investors, to prevent unauthorized use of their tangible and intangible products or to license their use in return for compensation. Intellectual property rights confer an exclusive protection which is generally granted for a limited time period and in a specified geographical territory, for actions resulting from the innovation, creation, and know-how of economically-active individuals and entities. **1.03**

These individuals and entities participate in the economic growth of developed countries by encouraging investment in research and development (R&D), while allowing businesses to consolidate their competitive positions in a globalized economy. Efficiently protected intellectual property rights encourage competition in good faith as well as stimulate investment in R&D, creation, and innovation that will allow humanity to tackle the challenges faced in the fields of renewable energy, protection of the environment, health care, and sustainable development. **1.04**

(1) *The principal intellectual property rights*

**1.05** Intellectual property rights are traditionally divided into two main categories:<sup>1</sup> industrial property rights, which include rights linked to industrial or manufacturing activity, and literary and artistic rights, including copyright and related rights.

**1.06** The following rights are, inter alia, considered to be intellectual property rights:

(a) **Trade marks**

**1.07** A trade mark right is the exclusive right over a distinctive sign which is used to distinguish products or services provided by a particular undertaking from those provided by other undertakings. It may consist of any sign capable of being represented graphically, particularly words, including names, designs, letters, numerals, the shape of goods or of their packaging. Trade mark rights are generally acquired by registering the trade mark, usually for an initial period of ten years, at the expiry of which the protection may be renewed for additional periods and theoretically indefinitely. The owner of a valid trade mark has an exclusive right to use it and to prohibit others from using an identical or a confusingly similar sign for identical or similar products. Member States of the European Union (EU) may also provide that the proprietor of a trade mark with a reputation shall be entitled to prevent unauthorized use in the course of trade of any sign which is identical with, or similar to, the trade mark in relation to goods or services which are *not* similar to those for which the trade mark is registered, where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark.

(b) **Design rights**

**1.08** A design is an exclusive right over the outer appearance of the whole or a part of a product resulting from the features of, in particular, the lines, contours, colours, shape, texture, and/or materials of the product itself and/or its ornamentation. In the EU, registered designs can be protected for up to twenty-five years. Under a unitary EU-wide law of designs, which supplements the protection that is available under the national laws of the Member States, unregistered Community designs are also afforded protection for three years from the date on which the design was first made available to the public in the EU.

(c) **Patents and supplementary protection certificates**

**1.09** A patent confers the exclusive right to use an invention on its inventor or its successor in title, in exchange for the disclosure of related technical information on a new product or process which solves a technical problem, which involves an inventive step, and is capable of an industrial application. It is a title issued by a national or a regional authority which describes an invention and creates a temporary exclusive right under which the patented invention can only be made, used, or offered for sale by the right-holder or with his authorization. This temporary monopoly allows the right-holder to act against infringers and to assign or license the rights. Patents last for a maximum of twenty years. The publication of the patent discloses information to the scientific community so as to stimulate further research and innovation. Patent rights are limited to a specific geographical territory, and so the patent-owner needs to apply for a patent in every jurisdiction in which he wishes his invention to be protected.

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<sup>1</sup> This publication does not intend to cover all intellectual property rights in detail. Readers who wish to learn more about the legal provisions that govern these various rights are invited to consult specialized publications (see, eg, T Cook, *EU Intellectual Property Law* (OUP: Oxford, 2010)).

A supplementary protection certificate (SPC) is a title which prolongs the period during which a patented medicinal or para-pharmaceutical invention or a plant protection product is protected for up to five extra years after the expiry date of a patent, with the objective of compensating the patentee for the time taken to obtain a marketing authorization for the product, during which he is unable to benefit from his invention. **1.10**

**(d) Plant variety rights**

A plant variety right, also called plant breeders' right, is the exclusive right granted to the breeder of a new variety of plant that gives him exclusive rights over the propagating material (including seed, cuttings, divisions, tissue culture) and harvested material (cut flowers, fruit, foliage) of a new variety. In order to enjoy protection, the new variety must be distinct, homogenous, and stable. Plant variety rights can last for up to thirty years. **1.11**

**(e) Geographical indications**

A geographical indication is an exclusive right over the denomination used as an identification for a product (typically, but not exclusively, a foodstuff or drink) which originates in a particular region or locality and has typical characteristics due to the place and method used to produce, manufacture, extract, or assemble it. Geographical indications are collective rights and all companies or producers of a particular region who abide by the production rules have the right to use the indication for products originating from that region. Unauthorized third parties are prohibited from using geographical indications if their products do not originate from the geographical area indicated or if they do not comply with the prescribed quality standards. **1.12**

**(f) Copyright<sup>2</sup> and related rights**

Copyright is an exclusive right to reproduce or communicate to the public reserved to the author of an artistic work. The work must be original, ie an intellectual creation which is marked by the personality of the author and in a material form that can be communicated to the public. Artistic works range from written texts, music, films, and photographs to computer programs and video games. Related rights (also called neighbouring rights) grant protection to auxiliaries and intermediaries who contribute to the dissemination of the work, including performers, music producers, and broadcasting organizations. Copyright protection applies from the moment the work is created and lasts for seventy years after the death of the author, whilst related rights last for fifty years in principle. There are numerous exceptions to copyright, which allow, under specific conditions, the reproduction of a protected work for personal or private or even public use. **1.13**

*(2) The strategic importance of intellectual property rights*

Efficiently protected intellectual property rights stimulate investment in R&D and in creation and innovation, and boost good-faith competition. **1.14**

Trade marks allow their owners to position themselves among their competitors from a product or service quality point of view. Consumers perceive trade marks as an indication of origin or as a rallying point for customers, inciting them to buy the same product again if they were pleased with their original purchase. A patent is a monopoly granted in exchange for the publication of an invention, which makes the technique available to the scientific community, which thus encourages progress and new research. Finally, copyrights protect the creative work of artists and creators. **1.15**

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<sup>2</sup> In civil law countries sometimes also called 'authors' rights'.

- 1.16** In addition, intellectual property rights boost the economies of developing countries by promoting technology transfers and foreign investment. The protection and defence of intellectual property rights is therefore strategically important, as much for the economies of developed countries as for those of developing countries.

## **B. Definition of counterfeiting and piracy and distinction from other forms of intellectual property right infringements**

### *(1) General acceptance of the terms*

- 1.17** Generally speaking, in current usage the words ‘counterfeiting’ and ‘piracy’<sup>3</sup> cover *an infringement of an intellectual property right*,<sup>4</sup> in other words the manufacture, distribution, commercialization, sale, import, or export of copies of products manufactured without the approval of the holder of the intellectual property right. This use of ‘counterfeiting’ and ‘piracy’ therefore not only targets the most flagrant infringements, but also includes infringements of intellectual property rights in the broad sense of the term.<sup>5</sup>
- 1.18** In English, current usage has adopted a dichotomy between infringements of industrial property rights (‘counterfeiting’) and infringements of literary or artistic property (‘piracy’).
- 1.19** Still, in current usage, ‘counterfeiting’ and ‘piracy’ also include other, diverse phenomena, such as counterfeit currency, piracy on the high seas,<sup>6</sup> and computer crime.

### *(2) Legal acceptance*

- 1.20** At a legislative level, there is no single definition of these concepts and the different legislatures (international, EU, and national) use different definitions which are applied in different areas.
- 1.21** Thus the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)<sup>7</sup> uses definitions for ‘goods bearing counterfeit trademarks’ and ‘pirated goods which infringe copyright’ given in note 14 under Article 51, which read as follows:

For the purposes of this Agreement:

- (a) ‘goods bearing counterfeit trademarks’ shall mean any goods, including packaging, bearing without authorisation a trademark which is identical to a trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the rights of the owner of the trademark in question under the law of the country of importation;
- (b) ‘pirated goods which infringe copyright’ shall mean any goods which are copies made without the consent of the right-holder or person duly authorised by the right-holder in

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<sup>3</sup> French ‘contrefaçon’ and ‘piraterie’; German ‘Produktpiraterie’ and ‘Plagiat’; Italian ‘contraffazione’ and ‘pirateria’, and Spanish ‘falsificación’ and ‘piratería’.

<sup>4</sup> OECD, *The Economic Consequences of Counterfeiting* (1998) p 6, <<http://www.oecd.org/dataoecd/11/11/2090589.pdf>> (accessed 1 February 2012).

<sup>5</sup> This definition also includes counterfeit services, even if they are rarely found. Note that a fake service station selling counterfeit BP petrol has been reported by the World Customs Organization; see *Contrefaçon riposte*, No 26, June-July 2007, p 3.

<sup>6</sup> Some regret the choice of the word ‘piracy’ for infringements of intellectual property rights because the term evokes romantic ‘Pirates of the Caribbean’-type buccaneers rather than a real threat to world commerce; see Charlie McCrevey, European Commissioner for the Internal Market’s contribution to the High Level Conference on Counterfeiting and Piracy, held in Brussels on 13 May 2008 (Speech/08/237) and also the Opinion of AG Damaso Ruiz-Jarabo Colomer, in Case C-132/07 *Beecham Group v Andacon NV* [2009] ECR I-1775, paras 2–5.

<sup>7</sup> Appendix 1C to the Marrakech Agreement of 15 April 1994 which set up the World Trade Organization.

the country of manufacture and which are made directly or indirectly from an article where the making of that copy would have constituted an infringement of a copyright or a related right under the law of the country of importation.

In the EU, 'counterfeit goods' and 'pirated goods' are defined in Article 2(1)(a) and (b) of Regulation 1383/2003 of 22 July 2003<sup>8</sup> as follows: **1.22**

- (a) 'counterfeit goods', namely:
  - (i) goods, including packaging, bearing without authorisation a trademark identical to a trademark validly registered in respect of the same type of goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the trademark-holder's rights under Community law, as provided for by Regulation 40/94 of 20 December 1993 on the Community trademark or the law of the Member State in which the application for action by Customs is made;
  - (ii) any trademark symbol (including a logo, label, sticker, brochure, instructions for use or guarantee document bearing such a symbol), even if presented separately, on the same conditions as the goods referred to in point (i);
  - (iii) packaging materials bearing counterfeit trademarks, presented separately, on the same conditions as the goods referred to in point (i);
- (b) 'pirated goods', namely goods which are, or contain, copies made without the consent of the holder of a copyright or related right or design right, regardless of whether or not it is registered in national law, or of a person authorised by the right-holder in the country of production in cases where the making of those copies would constitute an infringement of that right under Regulation 6/2002 of 12 December 2001 on Community designs or the law of the Member State in which the application for Customs action is made.

The definitions at international and EU levels are quite restrictive because they only cover the most flagrant infringements of intellectual property rights: so 'counterfeiting' covers trade mark infringements by goods bearing signs almost identical to a registered trade mark, and 'piracy' covers copies of goods made without the permission of the holder of a copyright, related right, or, in the case of Regulation 1383/2003, a design. What is more, infringements of certain intellectual property rights, such as patents and geographical indications, are not covered by these definitions.<sup>9</sup> **1.23**

In contrast, national legislation often opts for wide definitions of these concepts.<sup>10</sup> **1.24**

### (3) Other forms of intellectual property right infringements

It is important to keep in mind that there are other forms of intellectual property right infringements. Some of them are outlined below. **1.25**

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<sup>8</sup> Council Regulation (EC) No 1383/2003 of 22 July 2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights [2003] OJ L196/7.

<sup>9</sup> Note that they do nevertheless fall under Regulation 1383/2003, because Customs in the EU Member States are, by virtue of Article 2(1)(c), empowered to intervene in cases of infringement of other intellectual property rights than just trade marks, copyright, related rights, and design rights. '[G]oods which are subject of an action infringing a geographical indication and bear or are described by a name or term protected in respect of that geographical indication' are also included in the definition of 'counterfeit goods' provided by the 'Proposal for a Regulation of the European Parliament and of the Council concerning customs enforcement of intellectual property rights', COM (2011) 285 final, released by the European Commission on 24 May 2011 (see Art 2(5)).

<sup>10</sup> See, eg, the Belgian Law of 15 May 2007 on the punishment of counterfeiting and piracy of intellectual property rights, published in the *Moniteur Belge* (Belgian State Gazette) on 18 July 2007, p 38734, which relates to almost all deliberate intellectual property right infringements committed on a commercial scale.

**(a) Parallel imported ('grey') goods**

- 1.26** Counterfeiting and piracy need to be distinguished from unauthorized parallel imported goods, also called 'grey (or gray) goods'.<sup>11</sup> These are genuine goods, which have been manufactured by the right-holder or with his consent, have been placed on the market outside the European Economic Area (EEA) with the authorization of the right-holder, and then are imported into the EEA without the consent of the right-holder. European law does not recognize the principle of worldwide exhaustion of intellectual property rights, but solely exhaustion within the EU and the EEA. This means that, for intellectual property purposes, the EU/EEA territory is considered as a single market within which products protected by an intellectual property right may circulate freely once they have been placed on the market by the right-holder or with his consent. However, if the maker of a product which is protected in Europe by an intellectual property right puts it into circulation outside the EU/EEA, the product may not be imported and sold in the EU/EEA without his consent.
- 1.27** The right-holder can thus prohibit the sale of his product in the EU/EEA on the basis of his intellectual property right if he has put it on the market outside the EU/EEA, and it was not intended for sale in the EU/EEA.

**(b) Factory over-runs**

- 1.28** Yet another distinction has to be made with (factory) over-runs (also called 'moonshine production'). These are products that are manufactured by a contractual partner (this can include licensees and manufacturers) of the right-holder, but in breach of the agreement with the latter. In other words, these products represent excess volumes over the volumes agreed with the right-holder, produced in breach of the agreement because the producer of the goods has received the know-how or technology required to produce the goods, and then abused it. Sometimes over-runs are of the same or similar quality as genuine goods, but more often they are of a sub-standard quality because the manufacturer uses inferior raw materials or cheaper production processes. From a legal point of view, these over-runs are unauthorized and thus infringe the right-holder's intellectual property rights.
- 1.29** Right-holders who wish to have their goods manufactured in third-party countries are well advised to take elementary precautions, for example to restrict as much as possible the diffusion of confidential information. If, despite precautions, any form of know-how or trade secrets must be diffused, all the recipients must be made to sign confidentiality agreements. Production by licensees must be constantly inspected, and manufacturing licence agreements must contain audit clauses allowing the right-holder to inspect stock, accounting documents, and manufacturing premises.<sup>12</sup>

**(c) Look-alikes (parasitic copies)**

- 1.30** Look-alikes imitate the protected distinctive features of the packaging or trade dress used for a competitor's products, thus trying to divert consumers from those goods, without, however, necessarily using a counterfeit trade mark. There is no uniform protection against look-alikes

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<sup>11</sup> 'Grey goods' are goods purchased legally in one country which are then resold in another country without the permission of the right-holder in the country of resale. The importer can then take advantage of the difference in the price of the goods in the two different countries. In some sectors, links have been found between parallel imports and smuggling. Sometimes, parallel imports are used to conceal counterfeit goods; see M Blakeney, 'The phenomenon of counterfeiting and piracy in the European Union: factual overview and legal and institutional background' in O Vrins and M Schneider (eds), *Enforcement of Intellectual Property Rights through Border Measures. Law and Practice in the EU* (OUP: Oxford, 2006) p 6.

<sup>12</sup> For more examples, see R Ordish, 'Sourcing from China: stopping the IP leaks from your clients' supply chain' (2008) 3 JIPLP 30 and International Chamber of Commerce (ICC), *Countering counterfeiting—A guide to protecting and enforcing Intellectual Property Rights* (1997) pp 40 ff.

or parasitic copying in the EU, but in many Member States right-holders are protected by legislation on unfair competition law or passing-off.

## II. The Magnitude of the Counterfeiting and Piracy Problem and the Difficulty in Measuring it

### A. It is difficult to estimate the size of a problem and activities that are by definition clandestine

As for the global dimension of counterfeiting and piracy (in the narrow sense), various figures have been suggested and then partially denied: an OECD study dating from 1998 suggested that between 5 per cent and 7 per cent of global trade by value involved counterfeit or pirated goods.<sup>13</sup> **1.31**

This claim was challenged by the OECD itself in 2007, when it declared that no methodology could establish a serious estimate of the phenomenon, given the hidden and clandestine nature of the activities involved, the lack of precise statistics, and the difficulty of distinguishing counterfeit and pirated goods from genuine goods. In a 2007 report, the OECD concentrated on worldwide trade and the seizure statistics for counterfeit goods reported by Customs. These statistics led the OECD to claim that the international trade in counterfeit and pirated goods had been worth US\$200 billion in 2005. But the report stresses that the total value of trade in counterfeit and pirated goods, including those manufactured and sold within the same country, could exceed this figure of several hundreds of billions of dollars. This estimate does not include the value of counterfeit and pirated digital products distributed over the internet, which, if they were added, would significantly increase this figure.<sup>14</sup> An update of the study from 2009 suggests that counterfeit and pirated goods in international trade grew steadily over the period 2000–2007 and could have amounted to up to US\$250 billion in 2007.<sup>15</sup> **1.32**

If the figure for this ‘shadow economy’ were added, the overall figure could well come close to that cited by the Global Conference on Anti-Counterfeiting of €500 billion a year.<sup>16</sup> **1.33**

The OECD’s policy in its 2007 report of collating the figures reported by Customs has the advantage of being objective, because these figures cannot be challenged on a quantitative basis. However, the overall figure was reached by pure extrapolation, given that nobody knows how many counterfeit or pirated goods are not seized by Customs despite their use of sophisticated targeting techniques.<sup>17</sup> We must also note that border measures are only applied by EU Member State Customs at the external borders of the EU. **1.34**

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<sup>13</sup> OECD, *The Economic Consequences of Counterfeiting* (n 4) p 23. This figure has been interpreted by some as showing that 5% to 7% of the goods sold in international trade are counterfeits, others see it as a global figure which includes counterfeit goods manufactured and sold in the same country. Some others have even put forward higher figures, such as the World Economic Forum, which quoted a figure of 10% of world trade in 2006.

<sup>14</sup> OECD, *The Economic Impact of Counterfeiting and Piracy. Part I: Overall assessment*, DSTI/IND(2007)9/PART1, <<http://www.iccwbo.org/uploadedFiles/BASCAP/Pages/OECD-FullReport.pdf>> (accessed 1 February 2012).

<sup>15</sup> OECD, *Magnitude of Counterfeiting and Piracy of Tangible Products*, an update, November 2009, <<http://www.oecd.org/dataoecd/57/27/44088872.pdf>> (accessed 1 February 2012).

<sup>16</sup> Final communiqué of the First World Anti-Counterfeiting Conference, held in Brussels on 25 and 26 May 2004, <<http://www.ccapcongress.net/archives/Brussels/Files/french.pdf>> (accessed 1 February 2012).

<sup>17</sup> In Europe, a maximum of between 3% and 5% of goods imported into the Internal Market are inspected by Customs. See French National Assembly, *La lutte de l’Union européenne contre la contrefaçon* (8 June 2005) p 11, <<http://www.assemblee-nationale.fr/12/pdf/europe/rap-info/i2363.pdf>> (accessed 1 February 2012).

- 1.35** Therefore, all the figures quoted in this section are mere estimates, often based on data supplied by right-holders or sectorial organizations. The figures are thus not necessarily accurate because of the temptation to exaggerate them to obtain more government support, or to underestimate them so as not to alarm consumers.<sup>18</sup>
- 1.36** This is the reason why the Office for Harmonization in the Internal Market has launched a working group, in the framework of the Co-operation Fund, to develop a methodology for the collection and evaluation of data on counterfeiting and piracy, in order to establish neutral and reliable figures for the plague within the Internal Market.<sup>19</sup>

## B. From a small-scale backroom business to a global industry

- 1.37** Although there is no agreement on the size of the plague, observers can all agree that there has been a net increase over recent years,<sup>20</sup> and that counterfeiting and piracy have developed from a small-scale activity into one on an industrial scale. The old, small, clandestine workshops have become veritable industrial factories, able to flood the world market very quickly with massive numbers of infringing products to the detriment of players in the genuine economy.
- 1.38** In many sectors, there is evidence of improved quality of counterfeit and pirated goods, as well as an increase in their numbers. Infringing goods are becoming more and more difficult to distinguish from genuine goods, at least in their external appearance—which does not prevent them from containing hidden defects that can render them dangerous.
- 1.39** To this must be added the diversification of counterfeit goods. Whereas in the past mainly luxury goods have been subject to counterfeiting and piracy, today almost no product has escaped counterfeiting and piracy. This includes complex machines, spare parts for vehicles and planes, medicines, personal hygiene products, and food products.

## C. Factors that are driving the expansion

- 1.40** Many factors are driving this exponential expansion, including
- the growth in the number of commercial transactions and the globalization of international commerce;
  - the rapid growth in copying technologies, making it faster and cheaper to make counterfeit copies of genuine goods;
  - the boom in communications technologies and in online commerce which has made it easier to distribute goods and has broken commerce down into millions of micro-transactions that have made it easier for the parties to these transactions to remain anonymous;

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<sup>18</sup> Centre for Economics and Business Research, *Counting Counterfeits: Defining a Method to Collect, Analyze and Compare Data on Counterfeiting and Piracy in the Single Market* (2002), <[http://ec.europa.eu/internal\\_market/indprop/docs/piracy/final-report-cebr\\_en.pdf](http://ec.europa.eu/internal_market/indprop/docs/piracy/final-report-cebr_en.pdf)> (accessed 1 February 2012).

<sup>19</sup> <<http://oami.europa.eu/ows/rw/resource/documents/QPLUS/projectFund/cf423-summary.pdf>> (accessed 1 February 2012).

<sup>20</sup> Seizures of counterfeit goods by EU Customs increased by 1,000% between 1998 and 2004, see the Communication from the Commission on a customs response to the latest trends in counterfeiting and piracy, COM (2005) 479 final of 11 October 2005, p 29. This trend is global since US Customs recorded an increase of 83% in customs seizures in 2006 alone, see 'Counterfeit goods seizures up 83%' in 2006, <<http://www.cbp.gov>> (accessed 1 February 2012). According to INTERPOL, the trade in counterfeit goods has grown eight times more quickly than legitimate world trade since the 1990s, see M Naim, *Illicite* (Anchor books, 2006) p 112. The OECD study from 2007 agrees with these estimates because more than half the countries questioned reported a rise in the phenomenon and a quarter reported a *rapid* rise, see OECD, *The Economic Impact of Counterfeiting and Piracy. Part I: Overall assessment* (n 14).

- the very slight risk of being caught set against the opportunity to make huge profits;
- the growing involvement of organized crime;
- the opportunity copying offers to avoid having to invest in R&D and marketing;
- the lower cost of manufacturing in illegal sweatshops which do not comply with elementary health and safety requirements and whose employees are paid cash-in-hand without having to pay employer's tax and social security contributions;
- the huge increase in demand for branded goods;
- the current economic crisis, which has accelerated this phenomenon: in a period of falling demand, even legitimate licensees will prefer to keep their manufacturing facilities busy making counterfeit goods.

#### **D. The information available from Customs about the enforcement of intellectual property rights**

In accordance with Article 23 of Regulation 1383/2003<sup>21</sup> the European Commission publishes an annual report containing the statistics provided by Customs on the enforcement of intellectual property rights at the EU borders. **1.41**

##### *(1) Advantages and disadvantages of the figures*

The annual 'Report on EU Customs Enforcement of Intellectual Property Rights', published on the website of the European Commission's Directorate-General for Taxation and Customs Union (TAXUD),<sup>22</sup> gives a valuable insight into trends in relation to the cross-border flows of counterfeit and pirated goods. **1.42**

One of the main advantages of these annual reports is that the figures are transparent and neutral, since they are provided by Customs and not by right-holders. To ensure uniformity across the various EU customs authorities, the Commission has established clear rules on how the figures are to be collected.<sup>23</sup> **1.43**

Nevertheless, as already mentioned, such figures have been criticized: right-holders have correctly pointed out that Customs cannot check everything, and that only a tiny percentage of all the goods crossing the EU's external borders are subject to physical customs checks, and therefore the statistics can only show the 'tip of the iceberg'. Furthermore, the statistics do not take into account counterfeit goods manufactured and distributed within the EU. As will be explained in great detail later (see para 5.119), EU Customs can only inspect goods crossing the EU's external borders: within the EU the free movement of goods principle renders systematic border controls impossible. Last but not least, Customs can only check physical consignments of goods travelling by sea, air, or road, and so, for example, the illegal online sharing of pirated audio-visual products will never be included in the statistics. **1.44**

However, the figures should not be dismissed out of hand, for they do contain interesting insights and reveal trends, thus constituting a valuable source of information for right-holders and public authorities alike. **1.45**

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<sup>21</sup> See n 8.

<sup>22</sup> <[http://ec.europa.eu/taxation\\_customs/customs/customs\\_controls/counterfeit\\_piracy/statistics/index\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_controls/counterfeit_piracy/statistics/index_en.htm)> (accessed 1 February 2012).

<sup>23</sup> eg, cigarettes are counted by pack of 20 and shoes, socks, and gloves are counted by the pair.

(2) *Analysis of the figures for 2010*

(a) **Number of seizures and number of items seized**

- 1.46** The statistics show a sharp increase in the number of seizures made by Customs, whereas the number of items seized has remained constant or in slight decline over recent years. The figures for 2010 show an all-time high of 79,112 seizures, whereas the total number of items seized decreased slightly to 103 million (the all-time record was set in 2008, when nearly 179 million items were seized).
- 1.47** In its comments on the 2010 statistics, the Commission confirmed that there is a link to the increase in online sales. The online distribution of counterfeit products via ‘fake’ or ‘replica’ websites and online auction sites allows counterfeit goods to be shipped direct from the country of manufacture to consumers’ homes in a flood of small parcels, each containing a very small number of infringing articles, which poses a challenge, both for Customs to identify and intercept them, and also for the judicial and administrative authorities to cope with the huge numbers of subsequent court cases, which is out of proportion to the value of the counterfeit goods seized.
- 1.48** The statistics also show that some EU Member States appear to take the fight against counterfeiting and piracy more seriously than others by allocating proportionally more of their overall budgets and resources to fighting the plague: the top ten Member States together account for 90 per cent of all seizures and 87 per cent of all seized items.

(b) **Result of the seizures**

- 1.49** The statistics show that, in 91.5 per cent of customs seizures, the goods were either destroyed under the simplified procedure or a court case was initiated to determine whether or not an intellectual property right had been infringed. Overall, 7 per cent of the goods detained were thereafter released: either because they were found to be genuine or non-infringing goods (in 2.42 per cent of cases—a figure that shows how precisely Customs work) or because the right-holder decided not to take action after notification by Customs (in 4.56 per cent of cases). Only in 0.02 per cent of cases was a settlement reached between the right-holder and the owner of the goods which led to the release of the goods. This very low figure can probably be explained by the fact that Customs in many Member States do not allow right-holders to grant such retroactive licences.

(c) **Categories of goods seized**

- 1.50** By far the most common category of goods seized was cigarettes and other tobacco products (over 41 per cent of all seizures).<sup>24</sup> Customs are particularly keen to take action against counterfeit tobacco products since their placing onto the market also constitutes a fiscal offence. Other significant categories include office stationery (8.43 per cent—2010 saw a record number of counterfeit pencils seized<sup>25</sup>), clothing (6.71 per cent), and toys (6.52 per cent).

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<sup>24</sup> According to C Thompson (‘Illicit trade enjoying the rudest of health’, *Financial Times*, 31 December 2011–1 January 2012, p 10), ‘[t]he EU, with its porous borders and large, varied markets, has seen some of the steepest growth in illicit trade. In 2010, according to PMI [Philip Morris International], one in 10 European cigarettes smoked—64.2bn—were either untaxed or made with counterfeit tobacco, a rise of nearly 2 per cent, or 8bn illicit cigarettes, since 2006. While the UK average for consumption of illicit cigarettes is about 10 per cent of the total, in London it has risen to one in five and in cities such as Nottingham and Ipswich one in three. As for roll-up cigarettes, PMI estimates that half of all loose tobacco in the UK is illicit.’

<sup>25</sup> Clearly, some trends vary from year to year and the seizure of an entire container of a certain article will skew the statistics for the product category and its country of origin.

In addition to counting the number of items seized, Customs keep statistics on the numbers of goods seized by customs case. This presents a completely different picture: most of the *cases* relate to clothing (26.31 per cent of cases); sports shoes (13.65 per cent of cases); other types of shoes (19.68 per cent of cases); watches (5.94 per cent of cases); and bags, wallets, and purses (5.03 per cent of cases). Again the rise in online sales is reflected in these statistics, as most of the items seized had been ordered over the internet with direct delivery to the buyer. **1.51**

**(d) Value of the goods seized by Customs**

For the first time, the 2010 statistics provide the estimated value of the goods seized by Customs. The value used is the domestic retail sale value (the price at which the goods would have been sold in a retail outlet in the Internal Market had they been genuine). For 2010, the total value was €1,110,052,402 (€1.1 billion). Although this does not include the financial impact of counterfeiting and piracy on the EU economy, nor all financial losses suffered by right-holders due to the trade in counterfeit and pirated goods (besides the loss of sales, right-holders suffer other financial losses as will be outlined below), it is a very interesting indicator. **1.52**

By their domestic retail sale value, the top categories of seized goods are clothing (15.95 per cent); cigarettes (10.99 per cent); shoes (10.40 per cent); bags, wallets, and purses (9.25 per cent); and watches (8.81 per cent). **1.53**

**(e) Co-operation between Customs and right-holders**

Increased co-operation between Customs and right-holders is of paramount importance if the system of applications for customs action is to work smoothly. In 2010, the number of such applications for action reached an all-time high of 18,330, compared to just 1,000 in 2000.<sup>26</sup> **1.54**

The increasing importance of applications for customs action is also illustrated by the fact that, in 2010, less than 5 per cent of customs actions were initiated *ex officio*, that is *not* based on an application for action. This is a significant change from 2008, when 26.5 per cent of customs actions were still *ex officio*. These figures illustrate the trend towards Customs' co-operation with right-holders, who are more likely to submit preventive applications for action and to provide Customs with information on how to identify infringing goods. This has led to most right-holders submitting applications for action, 'just in case'. **1.55**

**(f) Countries of origin<sup>27</sup>**

The statistics single out China as the main country of origin for counterfeit goods, accounting for almost 85 per cent of all seized items. Next come India (3.48 per cent), Hong Kong (2.95 per cent), Turkey (2.44 per cent), and Moldova (2.06 per cent). **1.56**

Back in 2000, China accounted for 'only' 48 per cent of seized items, rising to 54 per cent in 2004. The recent rapid rise bears witness to increased openness and industrialization in China. **1.57**

The 2010 statistics also show that some countries seem to specialize in certain categories of counterfeit goods, such as Turkey for foodstuffs (94.93 per cent of all foodstuffs seized came from there), Thailand for beverages (98.05 per cent), Hong Kong for computer memory cards (65.43 per cent), and India for medicines (93.13 per cent). **1.58**

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<sup>26</sup> A 'Community-wide' application for customs action covering all 27 EU Member States counts as 27 applications in this statistic.

<sup>27</sup> It is worth noting that the 'country of provenance' is not always the 'country of origin' where the goods were manufactured. In fact, it is possible that the declared country of provenance is merely a country through which the goods have transited, since infringing goods often transit via several countries between their country of manufacture and the country of intended sale (see para 1.103). The statistics do, however, give an impression of the most common countries of provenance.

**1.59** Interestingly, EU Customs' export inspections revealed that within the EU, Italy was the main country of origin for counterfeit foodstuffs, and Bulgaria for packaging materials.

**(g) Travellers' personal luggage versus commercial-scale trafficking**

**1.60** It is not surprising to note that only 1 per cent of the items seized by Customs in 2010 were found in travellers' personal luggage, compared to 99 per cent in commercial shipments. This clearly shows that commercial consignments are still the most important source of counterfeits within the EU and possibly also that travellers' personal luggage is hardly checked by Customs in the EU.

**1.61** However, tourists who bring home counterfeit souvenirs from their holidays still account for a significant number of the cases. If we look at the number of cases initiated following seizures, rather than the number of items seized, we see a different picture: 7.85 per cent of the cases relate to goods seized from travellers' luggage and 92.15 per cent relate to goods seized in commercial consignments. The most common counterfeit items seized in travellers' luggage were cigarettes (51.43 per cent), directly followed by labels and tags (20.70 per cent). These tags and labels were probably being carried by individuals acting as couriers for counterfeiting gangs that would subsequently attach them to unbranded counterfeit goods. Other items seized from travellers were games (6.98 per cent); clothing (5.20 per cent); and, somewhat surprisingly, medicines (2.90 per cent).

**(h) Means of transport**

**1.62** It is rather alarming to note that most cases opened by Customs nowadays relate to postal traffic. Between 2009 and 2010, cases related to seizures from postal traffic have increased by a spectacular 82 per cent. As Customs have only limited resources, the focus on inspecting postal traffic means there are fewer inspections of goods travelling by air, road, and sea. However, this focus on postal traffic is amply justified, because nearly 69 per cent of these cases opened in 2010 related to fake medicines.

**1.63** Although in terms of goods seized, the most common source of seizures remains sea freight in ports, the number of such goods seized has fallen significantly: in 2010 they represented 81.63 per cent of items seized (some 84 million items). Clearly, the ports of Rotterdam, Antwerp, Hamburg, Genoa, and Marseilles are major points of entry for counterfeit goods to the EU, but the smaller ports, which are often targeted by traffickers because they are less well equipped (both in terms of the number of customs officers on duty and the sophistication of their equipment), should not be forgotten.

**1.64** 7.69 per cent of the infringing articles were discovered in lorries and we can assume that most of these originate from Eastern Europe and the former Soviet Union. 6.11 per cent of the infringing articles were travelling by air freight.

**(i) Further statistics**

**1.65** For further statistics on the number of seizures by type of intellectual property right and by type of customs procedure, please see paras 5.40 and 5.173 ff.

### III. The Economic and Social Consequences of Counterfeiting and Piracy

**1.66** All the available evidence indicates that infringements of intellectual property rights not only damage the subjective rights of the right-holders (Section A) but they also harm economic public order—damaging the countries where the counterfeit goods are manufactured as much as the countries where the counterfeit goods are sold (Section B).

The consumers who buy counterfeit goods play an ambivalent role: some are genuinely tricked into buying them, thinking they are buying genuine goods, while others deliberately buy counterfeit goods so as to have the kudos without having paid the full price (Section C). **1.67**

Counterfeiting can generate huge profits, making it attractive to many economic players, including traders in parallel imports; unscrupulous businessmen and wholesalers who mix together counterfeit and genuine goods to boost their margins; and, last, but certainly not least, organized crime syndicates. In addition, legions of intermediaries are also involved, including transport companies, landlords of commercial premises where counterfeiting takes place, and those who launder the cash involved in the payment chain. The advent of the internet has been a huge boost to this scourge by providing a new vector of distribution (see Section D for the economic role of intermediaries). **1.68**

### A. The economic consequences for right-holders

Right-holders can be individuals or companies that own intangible assets, or those authorized to use them. In other words, they are economic players who supply the market with genuine goods. **1.69**

The right-holders sell goods for which consumers have certain expectations in terms of quality and the image of the manufacturer. Setting aside the quality of the goods, the value of a brand<sup>28</sup> is mainly based on investments made in manufacturing techniques, product development, and marketing. Trade marks allow businesses to generate higher revenues than they would have been able to generate with unbranded goods, while protecting their investments. Holders of intellectual property rights are given a monopoly which rewards their creative efforts and allows them to recover investments (for copyrights and related rights, and designs) and their R&D efforts (for patents and SPCs). **1.70**

Counterfeiting and piracy destabilize businesses in all sectors, not just the world of luxury goods, as the myth would have us believe. The worst affected sectors are audio-visual,<sup>29</sup> software, clothing, automotive, tobacco, wines and spirits, and pharmaceuticals.<sup>30</sup> Mass-consumption goods are targeted to the extent that none can escape imitations: spare parts for cars, electrical goods, mobile phones, printer ink cartridges, mineral water, apples, tea, washing powder, condoms, etc.<sup>27</sup> The luxury goods sector has to face very high-quality copies and it is not uncommon to find counterfeit watches made of solid gold. **1.71**

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<sup>28</sup> Although the value of a brand can be difficult to estimate, certain brands are accorded huge values, sometimes more than all the company's other assets. In this respect, *Interbrand* publishes an annual list of estimated brand values in *Business Week*. The calculation of value takes into consideration the brand's strategic management, its marketing budget, its portfolio management budget, the extension of the range of products and services, its licensing policy, etc. See <[http://www.interbrand.com/best\\_global\\_brands.aspx](http://www.interbrand.com/best_global_brands.aspx)> (accessed 1 February 2012).

<sup>29</sup> In the audio-visual sector, the availability of a *single pirated copy* of a film on the internet is enough for it to be diffused all over the world. Such diffusion harms a wide range of people and organizations, including cinema owners, film distributors, film producers and directors, script-writers, scenery makers, photographers and cameramen, actors, translators, interpreters, sub-titlers, transporters, printers, and many more.

<sup>30</sup> For a sectorial approach, see Centre d'études internationales de la propriété industrielle (CEIPI), *Impacts de la contrefaçon et de la piraterie en Europe* (9 July 2004) pp 36 ff, <[http://ec.europa.eu/home-affairs/doc\\_centre/crime/docs/study\\_ceipi\\_counterfeiting\\_fr.pdf](http://ec.europa.eu/home-affairs/doc_centre/crime/docs/study_ceipi_counterfeiting_fr.pdf)> (accessed 1 February 2012); Global Anti-Counterfeiting Group (GACG), *Economic Impact of Counterfeiting in Europe*, June 2000, <<http://www.gacg.org/Content/Upload/Documents/eucebrFinal.doc>> (accessed 1 February 2012); Association des industries de marque (AIM), *Counterfeiting* (1999).

- 1.72** A study published in October 2009 confirms that infringements of intellectual property rights are growing constantly and that more than 15 per cent of all the businesses in the world, across all sectors, have been victims of counterfeiting and piracy in the last two years.<sup>31</sup>
- 1.73** For right-holders, counterfeiting has several undesirable effects. On a strictly material level, it leads to a loss of turnover, a reduction in profits, and a loss of market share. Elsewhere, counterfeiting also disrupts business distribution networks and incurs costs for pursuing infringements of intellectual property rights. Finally, counterfeiting causes moral damage by undermining the good name of the business, its brands, and its products.

*(1) Loss of profit and market share*

- 1.74** Counterfeiting has a direct impact on sales and thus on turnover. In many cases, counterfeit products compete with genuine products, thus reducing their market shares and putting pressure on retail prices. They make right-holders lose customers, either because they buy counterfeit products believing them to be genuine and are disappointed, or because they deliberately buy cheaper counterfeit products to save money. Counterfeiting also deprives businesses of royalties and other licensing revenues. For multinational businesses, the losses caused by counterfeiting can be very significant, and the more successful the product, the more likely it is that it will be copied. Counterfeiting has an even more disastrous effect on small and medium-sized businesses, which are less able to defend themselves.

*(2) Unfair competition*

- 1.75** Counterfeiting is also a distortion of competition because it allows the counterfeiters to take unfair advantage of the marketing and R&D investments made by creative and innovative businesses. This generates a loss of confidence in businesses which discourages investors. As the Court of Justice of the European Union (CJEU) put it in its judgment in Case C-487/07:<sup>32</sup>

As regards the concept of 'taking unfair advantage of the distinctive character or the repute of the trade mark', also referred to as 'parasitism' or 'free-riding', that concept relates not to the detriment caused to the mark but to the advantage taken by the third party as a result of the use of the identical or similar sign. It covers, in particular, cases where, by reason of a transfer of the image of the mark or of the characteristics which it projects to the goods identified by the identical or similar sign, there is clear exploitation on the coat-tails of the mark with a reputation.

*(3) Loss of goodwill*

- 1.76** Counterfeiting also damages brand images in the widest sense and the right-holders' reputation. On the one hand, a flood of cheap imitations damages the quality and exclusive image of a product and renders it less attractive. Consumers of luxury goods want to show off their good taste by purchasing and displaying them. When the market is infested by counterfeits, the exclusivity of luxury goods is diminished and the brand's exclusivity is diluted. Therefore, even if there is no direct loss of sales revenue (because the people who buy the counterfeits would probably not have purchased the genuine goods), there is an indirect loss of sales because the brand's attractiveness is diminished. On the other hand, a customer who inadvertently buys a counterfeit copy believing it to be genuine can be disappointed by the poor quality of the

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<sup>31</sup> PricewaterhouseCoopers, 'Global Economic crime survey 2009', <<http://www.pwc.com/crimesurvey>> (accessed 1 February 2012).

<sup>32</sup> Case C-487/07 *L'Oréal SA & ors v Bellure NV & ors* [2009] ECR I-5185, para 41.

product and may decide not to buy the brand again in the future, which will adversely affect future sales:

39. As regards detriment to the distinctive character of the mark, also referred to as 'dilution', 'whittling away' or 'blurring', such detriment is caused when that mark's ability to identify the goods or services for which it is registered is weakened, since use of an identical or similar sign by a third party leads to dispersion of the identity and hold upon the public mind of the earlier mark. That is particularly the case when the mark, which at one time aroused immediate association with the goods or services for which it is registered, is no longer capable of doing so . . .

40. As regards detriment to the repute of the mark, also referred to as 'tarnishment' or 'degradation', such detriment is caused when the goods or services for which the identical or similar sign is used by the third party may be perceived by the public in such a way that the trade mark's power of attraction is reduced. The likelihood of such detriment may arise in particular from the fact that the goods or services offered by the third party possess a characteristic or a quality which is liable to have a negative impact on the image of the mark.<sup>33</sup>

#### (4) Risk of (product) liability

The first reaction of most consumers who are injured by a faulty counterfeit product is to demand damages from the right-holder, who is prima facie liable for product safety. It is then up to the right-holder to prove that the consumer was injured by a counterfeit product, for which the right-holder cannot be held liable. This can be particularly difficult for foodstuffs and pharmaceuticals that have been used up by the consumer before the fault became evident.<sup>34</sup> **1.77**

In addition, right-holders are bound to take action against counterfeiters if the counterfeit products pose a threat to consumers' health and safety: failure to do so can mean that they become liable for damage caused by these products, if it can be proved that dangerous counterfeits existed that were difficult or impossible to distinguish from the genuine products, and that these products endangered consumers.<sup>35</sup> **1.78**

#### (5) Enforcement costs

The defence of intellectual property rights can cost businesses significant amounts, which many businesses treat, wrongly, as lost investments: the costs cover not only the inquiries to detect counterfeiting, but also the costs of legal counsel, court fees, awareness-raising campaign costs, lobbying costs, and the cost of providing technical assistance to Customs and the police. Many manufacturers also invest in preventative technical measures to stop copies being made of their products. Other means of preventing counterfeiting include restricting the circulation of confidential information and know-how, with particular care being taken at trade fairs, strict supervision of licensees, and occasional spot-checks on distributors and retailers.<sup>36</sup> **1.79**

Experience has shown that an aggressive approach by one right-holder can often drive counterfeiters to abandon counterfeiting his products and to turn instead to counterfeiting products that are less well-defended. **1.80**

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<sup>33</sup> Ibid, paras 39–40.

<sup>34</sup> M von Welser and A Gonzalez, *Marken- und Produktpiraterie: Strategien und Lösungsansätze zu ihrer Bekämpfung* (Wiley-VCH, 2007) p 49.

<sup>35</sup> See 'Proposal for a Directive of the European Parliament and of the Council on measures and procedures to ensure the enforcement of intellectual property rights', COM (2003) 46 final, p 9.

<sup>36</sup> ICC (n 12) pp 40 ff.

## B. Economic and social consequences for countries<sup>37</sup>

**1.81** Counterfeiting is undoubtedly a threat to economic public order. When examining the consequences of counterfeiting, a distinction should be made between the countries where the counterfeit goods are sold and those where the counterfeit goods are manufactured.

### (1) *The countries where the counterfeit goods are sold*

**1.82** Although counterfeit goods are sold in every country, the vast majority are commercialized in high-price markets like Europe and America.<sup>38</sup> Some goods seem to enjoy varying success in different geographical markets: for example the Middle East is a thriving market for fake spare parts for cars, whereas South America, Africa, and Asia are better places to sell counterfeit tobacco, alcoholic drinks, electrical components, and cosmetics. While strictly-applied restrictions have limited the distribution of fake pharmaceuticals in the legitimate supply chain of developed countries, they are widely available in Africa. Piracy levels for audio-visual works and software are relatively high in all economies, but particularly high in the most developed countries.<sup>39</sup>

**1.83** The governments of countries where counterfeit products are sold experience direct economic losses, losses of jobs, and losses of fiscal and social security revenues.

#### (a) **Consequences for the Gross Domestic Product**

**1.84** The direct economic losses, above all caused by the reduction in GDP, are difficult to quantify.<sup>40</sup>

#### (b) **Loss of jobs**

**1.85** Counterfeiting destroys genuine jobs in developed countries because falling sales mean right-holders need fewer employees. The European Commission estimates that the social impact of counterfeiting in the EU is the loss of 100,000 jobs a year. Worldwide, counterfeiting would be responsible for the loss of several hundred thousand jobs a year.<sup>41</sup>

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<sup>37</sup> See, on this subject, von Welser and Gonzalez (n 34).

<sup>38</sup> M Roudaut, 'Contrefaçon en Europe: le vent en poupe', Fondation Robert Schuman, *Questions d'Europe*, No 86, 14 January 2008, p 2.

<sup>39</sup> OECD, *The Economic Impact of Counterfeiting and Piracy. Part I: Overall assessment* (n 14) p 80.

<sup>40</sup> A study done in 2000 quantified the direct losses for the EU Member States at more than €8 billion. This astonishing figure is based on 1995 figures. See Centre for Economics and Business Research (CEBR), study for the Global Anti-Counterfeiting Group (ACG), and GACG, *Economic Impact of Counterfeiting in Europe* (June 2000) (n 30).

<sup>41</sup> European Commission's Green Book of 15 October 1998: 'Combating Counterfeiting and Piracy in the Single Market', COM (98) 569 final. In a press release dated 11 October 2005 (MEMO/05/364) (<<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/05/364&format=HTML&aged=0&language=EN&guiLanguage=fr>>; accessed 1 February 2012), the European Commission quoted a figure of 200,000 jobs lost in Europe. The 'Guide to Border Enforcement of Intellectual Property Rights in the EU' (IPR-Helpdesk) refers on p 3 to 100,000 jobs a year in the EU and 120,000 jobs a year in the USA between 1996 and 2006, <[http://www.corporaciontecnologica.com/cta/html/portal/com/bin/contenidos/IDI/documentos/documentacion\\_idi/1184323548753\\_patentes\\_y\\_propiedad\\_intelectual.pdf](http://www.corporaciontecnologica.com/cta/html/portal/com/bin/contenidos/IDI/documentos/documentacion_idi/1184323548753_patentes_y_propiedad_intelectual.pdf)> (accessed 1 February 2012). In France alone, the Comité National Anti-Contrefaçon (CNAC) estimates the number of jobs lost at 30,000, see CNAC, *Contrefaçon Danger* (2004) p 5, <<http://www.contrefacon-danger.com/ressources/documents/dossierinformation.pdf>> (accessed 1 February 2012). According to the software sector, reducing piracy levels by 10% in Western Europe would create 200,000 jobs in four years, see Business Software Alliance (BSA), *Expanding Global Economies: The Benefit of Reducing Software Piracy* (2003), <[http://no.logos.free.fr/bib/White\\_Pape%281%29r.pdf](http://no.logos.free.fr/bib/White_Pape%281%29r.pdf)> (accessed 1 February 2012).

**(c) Loss of tax and social security revenues**

Counterfeiting leads to reduced fiscal and social security revenues: on the one hand, fraudulent declarations of the value of goods going through Customs deprives the states of excise duty revenues (if indeed they are declared to Customs at all) and the VAT and income tax payable by the sellers are not paid because the goods are sold via parallel distribution systems outside the legitimate tax system.<sup>42</sup> On the other hand, the growth in unregulated places of work means the non-payment of employers' and employees' tax and social security contributions and non-compliance with health and safety at work standards. **1.86**

**(d) Environmental consequences**

Counterfeiting also has adverse effects on the environment. First, there is the environmental impact of destroying counterfeit goods, tens of millions of items in Europe alone. Second, many counterfeit products are highly polluting, such as counterfeit pesticides, which often contain highly toxic ingredients and are much more noxious than the genuine, highly-regulated products. **1.87**

**(e) The cost of fighting counterfeiting**

What is more, the countries that are victims of counterfeiting have to invest large amounts to attempt, helped by law-enforcement agencies, to contain the problem. Often, national law empowers several different agencies, including Customs, the police, and Trading Standards officers to pursue infringers of intellectual property rights. **1.88**

In general, governments have enough incentives to act—at the very least there is pressure from their business communities and public opinion—in the fight against counterfeiting. If, nevertheless, governments do not take the necessary actions, those which are members of organizations such as the World Trade Organization risk finding themselves the object of proceedings by other Member States or the organization as a whole, who care more about protecting intellectual property. **1.89**

*(2) States where counterfeit goods are produced*

Although known all over the world, the main countries of origin for counterfeit goods are in Asia, most particularly China.<sup>43</sup> Other well-known sources of counterfeit goods are India, Russia and the former Soviet Union countries, and North African countries. In Europe, the commonest sources of counterfeit goods are Turkey, Italy, Bulgaria, Romania, and the newer EU Member States in general.<sup>44</sup> **1.90**

**(a) Loss of foreign investment**

The absence of efficient enforcement of intellectual property rights leads to a loss of foreign investment in, and of the transfer of knowledge and know-how to, countries that are notorious sources of counterfeit goods. For there is a clear interaction between the level of protection of **1.91**

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<sup>42</sup> According to the Business Software Alliance (BSA) reducing piracy by 10% worldwide would generate an additional \$64 billion in tax revenues, see BSA (n 41) p 2.

<sup>43</sup> According to the statistics published by the European Commission, almost 85% of the goods seized came from China. See para 1.56 and <[http://ec.europa.eu/taxation\\_customs/resources/documents/customs/customs\\_controls/counterfeit\\_piracy/statistics/statistics\\_2010.pdf](http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_controls/counterfeit_piracy/statistics/statistics_2010.pdf)> (accessed 1 February 2012). In the USA, 80% of goods seized by value in 2010 came from China or Hong Kong, see US Immigration and Customs Enforcement, *Seizure statistics: FY 2010*, <[http://www.cbp.gov/linkhandler/cgov/trade/priority\\_trade/ipr/ipr\\_communications/seizure/seizure\\_stats\\_fy2010.ctt/seizure\\_stats\\_fy2010.pdf](http://www.cbp.gov/linkhandler/cgov/trade/priority_trade/ipr/ipr_communications/seizure/seizure_stats_fy2010.ctt/seizure_stats_fy2010.pdf)> (accessed 1 February 2012).

<sup>44</sup> See <[http://ec.europa.eu/taxation\\_customs/resources/documents/customs/customs\\_controls/counterfeit\\_piracy/statistics/statistics\\_2010.pdf](http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_controls/counterfeit_piracy/statistics/statistics_2010.pdf)> (accessed 1 February 2012). The presence of the UAE and Switzerland in this list can doubtless be explained by the use of these countries as transit hubs or free zones.

intellectual property rights and the amount of direct foreign investment in factories and R&D facilities: adequate protection of intellectual property leads to an increase in investment, sometimes more than would be expected compared to other political and economic variables such as the size of the market, the level of government investment, the country's external debt, exchange rates, political stability, the quality of the labour force, the geographic proximity of the countries from which the investments come, or local government's control of commerce.<sup>45</sup> Transnational businesses look for a commercial environment in which their goods and services will be properly protected against counterfeiting and unfair competition. The amount of care taken by a government to secure this environment where intellectual property is protected is thus crucial.

**(b) Loss of tax and social security income**

- 1.92** Of course, the 'producer' countries suffer as much as the destination countries for counterfeit goods from the fiscal consequences, because counterfeiters have no interest in paying income tax on their clandestine activities.

**(c) Loss of jobs and unhealthy social climate**

- 1.93** Even if counterfeiting could, at first, claim to create jobs, it can cause adverse repercussions on the employment market by creating a loss of foreign investment. In addition, the economic environment created by counterfeiters is not healthy: it often involves parallel or 'black' economies, which exploit clandestine workers and avoid any sort of social inspection by the authorities. Counterfeit and pirated goods are often produced in breach of basic safety rules in so-called 'sweat-shops'.
- 1.94** In some cases, counterfeiting is a consequence of the theft of manufacturing secrets and know-how from right-holders, who have goods made under licence in countries which protect intellectual property less: qualified employees are lured away by the counterfeiters, who sometimes even partially convert whole factories to illegal work producing so-called 'over-runs'.

**(d) Co-operation with third-party countries**

- 1.95** Co-operation at government level and co-operation agreements under which more inspections are performed on exported goods are supposed to have reduced the impact of counterfeiting and piracy within the EU.<sup>46</sup>

**(e) Consequences for local consumers and businesses**

- 1.96** The least-developed countries suffer just as much from counterfeiting as developed countries. Indeed, there are fewer obstacles to imports of counterfeit goods, because official inspections are less sophisticated. This can lead to the market being flooded with counterfeit goods which are often dangerous for consumers. Even local businesses suffer from the pirating of traditional folk craft goods.<sup>47</sup>

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<sup>45</sup> See OECD, *Incidence des droits de propriété intellectuelle sur l'investissement direct étranger et le commerce dans les pays en développement* (May 2003) (*The impact of trade-related intellectual property rights on trade and foreign direct investment in developing countries*), <<http://www.oecd.org/dataoecd/59/46/2960051.pdf>> (accessed 1 February 2012).

<sup>46</sup> See paras 4.111 ff.

<sup>47</sup> See, eg, 'Le textile camerounais menacé par la contrebande et la contrefaçon', Afrik.com, 8 February 2006, <<http://www.afrik.com/article9449.html>> (accessed 1 February 2012).

(f) Environmental consequences

The producers of counterfeit and pirated products often fail to comply with basic environmental protection regulations. As a result, the factories where counterfeit goods are made are often major pollution sites. **1.97**

C. Consequences for consumers

(1) *The ambivalent role of consumers*

We mean ‘ambivalent’ because some counterfeiting would not exist were it not for consumer complacency:<sup>48</sup> demand for cheap goods<sup>49</sup> and the too-widely-held opinion that ‘counterfeiting and piracy are only minor offences which don’t really hurt anybody’,<sup>50</sup> have fed the plague. In this context, it is more than ever essential to raise the awareness of the public about the damage caused by counterfeiting and piracy, and to its links with organized crime and child labour.<sup>51</sup> Further awareness-raising about copyright as a protector of continuing culture would also appear to be desirable.<sup>52</sup> Finally, it is of primordial importance to develop a sense of responsibility among consumers, even if it means adopting a zero tolerance approach by law-enforcement authorities against infringements of intellectual property rights.<sup>53</sup> For it is difficult to reconcile the priority given to the fight against counterfeiting<sup>54</sup> with the generally lax approach of Customs to the detection of counterfeit goods in travellers’ personal luggage, which can thus be used to smuggle huge amounts of goods in small quantities, the so-called ‘ant-like traffic’.<sup>55</sup> **1.98**

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<sup>48</sup> M Roudaut (n 38) pp 9–10, thinks, rightly, that ‘only action to reduce demand will reduce the phenomenon ... as long as there are consumers who want to “get a bargain” by buying goods they know to be copied, there will be counterfeiters willing to sell them those goods’.

<sup>49</sup> The Anti-Counterfeiting Group (ACG) reports that in 2003 one-third of consumers were prepared to buy counterfeit products if the price and quality were right, see ACG, *Why You Should Care About Counterfeiting* (2003) p 2, <<http://counterfeiting.unicri.it/docs/Why%20You%20Should%20Care%20about%20counterfeiting.%20ACG.%20UK.pdf>> (accessed 1 February 2012).

<sup>50</sup> ‘Many know that it is illegal to buy counterfeit goods but continue to think that it is a victimless crime, except for the huge multi-nationals who own the rights, who do not receive much sympathy from the general public’, Union des Fabricants, *Rapport Contrefaçon & Criminalité Organisée* (3rd edn, 2005) p 5, <<http://counterfeiting.unicri.it/docs/Union%20des%20Fabricants.Rapport%20sur%20la%20contrefaçon%20et%20la%20criminalité%20organisée.3ème%20édition2005.FRENCH.pdf>> (accessed 1 February 2012).

<sup>51</sup> ‘Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee—An Industrial Property Rights Strategy for Europe’, COM (2008) 465 final, p 17.

<sup>52</sup> ‘Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions on Creative online content in the Single Market’, COM (2007) 836 final, p 8.

<sup>53</sup> See *An Industrial Property Rights Strategy for Europe* (n 51), which refers to *Effects of counterfeiting on EU SMEs and a review of various public and private IPR enforcement initiatives and resources*, report to the Enterprise and Industry Directorate-General, <[http://www.iccwbo.org/uploadedFiles/BASCAP/Pages/counterfeiting\\_main\\_report\\_final\\_4506.pdf](http://www.iccwbo.org/uploadedFiles/BASCAP/Pages/counterfeiting_main_report_final_4506.pdf)> (31 August 2007) (accessed 1 February 2012).

<sup>54</sup> Some states, such as Italy, have not hesitated to criminalize consumers who knowingly buy counterfeit goods, by fining them between €2,000 and €10,000.

<sup>55</sup> ‘One of the principal distribution channels for counterfeit goods is, without doubt, individual travellers who bring back souvenirs from their holidays like an army of ants. In this way, every year, tens of millions of items are transported ... [A]ccording to an opinion poll by M.O.R.I. (Market and Opinion Research International), 40% of the people questioned would buy counterfeit goods’. See European Commission’s website, <[http://ec.europa.eu/taxation\\_customs/customs/customs\\_controls/counterfeit\\_piracy/index\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_controls/counterfeit_piracy/index_en.htm)> (accessed 1 February 2012).

(2) *Economic losses for consumers*

**1.99** However, a growing number of consumers are being fooled by copies which are often very difficult to tell from genuine goods, and which are sold at almost the same prices. This is a consequence of the increasingly professional nature of the counterfeiting industry, that has allowed it to attack high-tech goods with high added-value. In cases where a consumer buys a product he thinks is genuine and then finds out it is a fake, he will usually complain to the manufacturer of the genuine products about how poor his product quality has become. This renders the genuine products less attractive because the consumer was disappointed by what he purchased. The consumer has also been extorted, because he would not have paid a high price had he known he was buying a copy.

(3) *Risk to health and safety*

**1.100** In many cases, counterfeit goods endanger the health and safety of consumers: fake batteries for mobile phones that explode,<sup>56</sup> pirated spare parts for motor vehicles and aeroplanes,<sup>57</sup> toys that fail to comply with elementary safety standards,<sup>58</sup> and fake medicines.<sup>59,60</sup> There are many examples of sickness and death linked directly to the consumption or use of counterfeit goods:

- During an epidemic of meningitis in Niger in 1995, a fake vaccine was administered which killed around 2,500 people.<sup>61</sup>
- In Russia in 1994, 53,000 people died after drinking adulterated vodka.<sup>62</sup>
- Several air accidents have been caused by planes being fitted with pirated spare parts.<sup>63</sup>
- In the United States (USA), millions of fake tablets containing boric acid, wax, and yellow road-paint have been seized.<sup>64</sup>

(4) *Absence of guarantees*

**1.101** Given the illegal origins of counterfeit goods, consumers usually receive no after-sales service and no guarantees. On the other hand, they can invoke the right-holder's liability for genuine

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<sup>56</sup> <<http://www.zdnet.fr/actualites/internet/0,39020774,39130975,00.htm>> (accessed 1 February 2012).

<sup>57</sup> According to an OECD estimate, the amount of fake spare parts for cars sold worldwide rose from 5% in 2000 to 10% in 2005. In the USA, the Federal Aviation Administration estimates that 2% of all the spare parts fitted to US planes each year are fake, which means about 520,000 fake parts. French National Assembly (n 16) p 35. CEIPI (n 29) pp 75–8.

<sup>58</sup> Toy Industries of Europe, 'The importance of IPR protection in the fight against counterfeiting of toys', <[http://tietoy.org/IMG/pdf/the\\_importance\\_of\\_ipr\\_protection\\_in\\_the\\_fight\\_against\\_counterfeiting\\_of\\_toys.pdf](http://tietoy.org/IMG/pdf/the_importance_of_ipr_protection_in_the_fight_against_counterfeiting_of_toys.pdf)> (accessed 1 February 2012).

<sup>59</sup> In the vast majority of cases, fake medicines either contain no active ingredient or the wrong active ingredient or the wrong dose of the correct active ingredient. This practice not only has direct consequences for the patients who ingest the medicines, but also unexpected, indirect consequences, eg because smaller doses of anti-malarial antibiotics can help the bacteria and mosquitoes develop a resistance to the correct dose. See World Health Organization (WHO), *Counterfeit Drugs in Brazil: The Public Health Dangers and Potential Solutions* (2001); other WHO studies include *Counterfeit medicines—Guide on the development of measures to eliminate counterfeit medicines* (2000); *Counterfeit and Substandard Drugs in Myanmar and Viet Nam* (2000), <<http://apps.who.int/medicinedocs/pdf/s2276e/s2276e.pdf>> (accessed 1 February 2012). In Nigeria, between 40% and 60% of medicines sold are counterfeit: see *Counterfeit Drugs in Nigeria and Current Interventions* (2003).

<sup>60</sup> For other examples, see CEIPI (n 29) p 21, and International Intellectual Property Institute, *Counterfeit Goods and the Public's Health and Safety* (July 2003), <<http://www.iccwbo.org/uploadedFiles/BASCAP/Pages/public%20health%20and%20safety.pdf>> (accessed 1 February 2012).

<sup>61</sup> WHO, 'Medicines: spurious/falsely-labelled/falsified/counterfeit (SFFC) medicines', Fact sheet No 275, <<http://www.who.int/mediacentre/factsheets/fs275/en/>> (accessed 1 February 2012).

<sup>62</sup> French National Assembly (n 17) p 33.

<sup>63</sup> CEIPI (n 30) p 78.

<sup>64</sup> Blakeney (n 11) p 17.

goods and can sue the right-holder claiming that counterfeit goods sold as genuine fall under his product quality liability, and the right-holder may well find himself liable if he is unable to identify the real source of the goods.<sup>65</sup> To avoid damaging their public image, right-holders prefer to settle out of court with consumers who have suffered damages caused by defective counterfeit products.

#### D. The economic role of intermediaries

Counterfeiting often involves a very large number of intermediaries. A distinction should be made between intermediaries in the real world and those in the virtual world. **1.102**

In the real world, most of the intermediaries are transport companies and express couriers. **1.103**  
In some cases, these transport companies cannot reasonably deny that they are unaware that their customers are involved in counterfeiting. Many traffickers of counterfeit goods practise the so-called 'transloading' or 'clean-break'<sup>66</sup> system, where the journey of the goods is temporarily stopped in a neutral area, such as a free customs zone<sup>67</sup> in an attempt to hide the real origin of the goods. This technique has been borrowed from drug-smuggling and aims to get round Customs' vigilance because the goods appear to have come from a low-risk country. Another technique involves giving the goods a 'pedigree' or 'provenance': thus fake vehicle spare parts from China transit via the USA to give them an air of authenticity and fake medicines from Asia are trans-shipped through the EU en route to Africa.<sup>68</sup> There are many other circumstances in which the transporter who loads goods in suspicious places must wonder whether his customers are involved in illegal activity.<sup>69</sup>

Next there are the owners of commercial buildings in which counterfeit goods are manufactured, stored, or sold. Disillusioned right-holders who have become frustrated by the failure of attempts to prevent counterfeiting may increasingly target unscrupulous owners of the property where counterfeiting takes place. Thus, the USA and China have seen the creation of a significant amount of case law about 'landlord liability' where the landlords of premises can be held liable, for example if their premises are repeatedly used for the sale of counterfeit goods.<sup>70</sup> **1.104**

In the virtual world, we find the same transport companies, express couriers, financial intermediaries, and property owners. Financial service providers also play an important role, because without financial intermediaries there would be no business of selling counterfeit goods over the internet. Specific to the virtual world are internet service providers and domain hosts, not forgetting search engines, online auction sites, and domain-name and affiliated platform registries. **1.105**

This explains why right-holders have recently multiplied their actions against intermediaries to explore the limits of the intermediaries' liability.<sup>71</sup> **1.106**

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<sup>65</sup> See 'Proposal for a Directive of the European Council and Parliament on measures and procedures to ensure the respect of intellectual property rights' (n 35) p 9.

<sup>66</sup> In French '*rupture de charge*'.

<sup>67</sup> Free customs zones are frequently used by international traffickers as places to trans-ship goods as they have no restrictions on the import or export of counterfeit and pirated goods, see <[http://ec.europa.eu/taxation\\_customs/customs/customs\\_controls/counterfeit\\_piracy/index\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_controls/counterfeit_piracy/index_en.htm)> (accessed 1 February 2012).

<sup>68</sup> Commission Communication of 11 October 2005 (n 20).

<sup>69</sup> For an illustration in relation to grey goods, see *Eli Lilly Co & anor v 8PM Chemist Ltd* discussed at para 5.201.

<sup>70</sup> For more information on this subject, see J Simone, 'In court, punish the landlord—a new weapon in the fight against counterfeiting in China' (2007) 6 WIPO Magazine 16, and P O'Byrne and R Burstall, 'Liability of landlords for infringing activities' (2011) 6 JIPLP 738.

<sup>71</sup> See L Pechan and M Schneider, 'Carriers and trade mark infringements: should carriers care?' (2010) 5 JIPLP 350.

## E. Counterfeiters' identity parade

- 1.107** Counterfeiters come in all shapes and sizes: they can be parallel importers of goods, occasional sellers of one-off 'dubious' goods, or wholesalers trying to boost their margins by mixing genuine goods with counterfeit goods.<sup>72</sup> These wholesalers generally perform many complex transactions, each with different counterparties so as to hinder any inquiry by law-enforcement agencies and to make the origin of the goods untraceable.
- 1.108** Those who manufacture counterfeit goods usually have much lower production costs than the manufacturers of genuine goods. Their manufacturing facilities are often located in developing countries with very low labour costs. The quality—and thus the price—of the raw materials used is very low. In many cases, the premises do not comply with local health and safety standards and the workers are employed illegally. To this should be added the lack of quality control. Most counterfeiters do not keep proper accounts and their activities do not require financing, as all transactions are done in cash to avoid any traceability. Nor do they burden themselves with social security contributions or tax, which also helps to reduce their running costs.
- 1.109** Counterfeit goods can be made by individuals working alone in their workshops,<sup>73</sup> but the manufacturing of counterfeit goods on an industrial scale is more and more controlled by organized crime.<sup>74</sup>
- 1.110** Selling counterfeit goods makes a bigger profit than selling illegal drugs, and involves much less risk for the traffickers. According to the European Commission, a kilo of cannabis sold in Europe generates less than €2,000 profit, whereas a kilo of pirated CDs generates €3,000 profit.<sup>75</sup> This explains the involvement of organized crime in the manufacture and/or distribution of counterfeit goods. Investment in counterfeiting allows organized crime groups to launder money obtained from other illegal sales, to diversify their revenue streams, and to use skills developed in smuggling (segmented deliveries, use of concealment means) in another field. This has led to the involvement of Asian organized crime groups (such as the Chinese triads and the Japanese mafia) with the Italian Camorra<sup>76</sup> and the Albanian mafia.<sup>77</sup> Some organized crime groups have even managed to vertically integrate their circuits, controlling everything from the manufacturing to the distribution and sale of the counterfeit goods to consumers.<sup>78</sup> Some have not hesitated to declare that 'infringements of intellectual property rights will probably be the biggest criminal threat of the twenty-first century'.<sup>79</sup>
- 1.111** Less detectable than the involvement of organized crime is the involvement of terrorist groups, who use counterfeiting as a discreet source of revenue. During a hearing before a US Congress

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<sup>72</sup> According to Roudaut (n 38) p 5, it is the penetration of legal distribution circuits by counterfeiters that represents the major threat from counterfeiting. The most professional organized crime groups thus attempt to penetrate the legal market, notably by becoming suppliers to wholesalers.

<sup>73</sup> eg, workers who have retired or been made redundant who continue to use their skills, or clandestine workshops that produce illegal digital copies of films, music, or software.

<sup>74</sup> Roudaut (n 38) p 7.

<sup>75</sup> "Operation Diabolo", an international customs operation led by OLAF, seized 135 million counterfeit branded cigarettes and 557,000 other counterfeit products', European Commission Press Release IP/07/515 (19 April 2007), <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/515&format=HTML&aged=1&language=EN&guiLanguage=fr>> (accessed 1 February 2012).

<sup>76</sup> R Saviano, *Gomorra: Dans l'empire de la Camorra* (Gallimard, Paris, 2007) pp 53–78.

<sup>77</sup> Union des Fabricants (n 50) pp 23 ff.

<sup>78</sup> Using illegal labour at all these levels.

<sup>79</sup> Roudaut (n 38) p 2. See also T Phillips, *Knockoff: The Deadly Trade in Counterfeit Goods* (Kogan Page, 2005).

committee, the Secretary-General of INTERPOL, Mr Ronald K Noble, gave several examples of counterfeiting having been used to finance terrorism.<sup>80</sup>

## IV. Conclusion

Counterfeiting is decidedly the crime of the 21st century which poses a serious threat to our society and the knowledge-based economy. **1.112**

For right-holders there is only one solution: if they want to remain competitive and not lose the benefits of their intellectual property rights, they have no choice but to join the fight against counterfeiters. If they choose to ignore them, they will end up being forced to give way to them, and will eventually be squeezed out of the market altogether. **1.113**

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<sup>80</sup> Testimony under oath given on 16 July 2003 by Mr Ronald K Noble, Secretary-General of Interpol, to the US House Foreign Relations Committee, 'The Links between Intellectual Property Crime and Terrorist Financing', <<http://www.iccwbo.org/uploadedFiles/BASCAP/Pages/links.pdf>> (accessed 1 February 2012).