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Counterfeit goods and product liability

The added value that has been built in branded goods, usually through many years of investment by the brand owner, provides a powerful attraction and incentive to manufacturers of counterfeit goods who are harnessing the power of the internet and global supply routes in growing numbers.

Whilst the most obvious cost to manufacturers is loss of revenue and profits, there are other costs in terms of endangered jobs, brand protection and enforcement and defending potential product liability claims.

John Reynolds of Shook Hardy & Bacon International LLP considers some of the consequences and product liability implications faced by manufacturers whose products are imitated by counterfeiters.

MARKET DRIVERS

One of the first steps in developing a strategy to combat counterfeiting is to recognise that this is a challenge on many fronts:

- Financial: the incentives are huge, with premium brands attracting a high margin for counterfeiters.
- Manufacturing: weaknesses in security can leak designs, recipes etc and in some cases both employees and members of the supply chain collaborate with counterfeiters.
- Demand: weak and emerging economies are looking for low-cost alternatives facilitated via the internet.

- Distribution: there are many opportunities to infiltrate complex international supply chains.
- Culture: some cultures are much more accepting of counterfeiting activity.
- Political: generating jobs for a local economy may be a more important objective than enforcement of intellectual property (IP) rights.

PRODUCT SAFETY

Genuine manufacturers spend time and money developing products that are safe and ensuring compliance with all necessary regulatory requirements. However, counterfeiters operate outside the law and compromise safety and integrity to cut corners. Counterfeiters aim to make cheap passable imitation goods and do not attach the same importance to safety as genuine manufacturers do, having no concern for the potential impact to reputation. The obvious lack of procedures for complaint and the illicit nature of the market means that counterfeiters operate without comeback or accountability.

While some counterfeiters have become highly specialised and adept at imitating genuine goods to what may appear to be an equivalent quality standard, there are also many producers whose imitations are dangerous to consumers and present a product liability risk if customers suffer an accident or injury.

There is a particular risk that counterfeit pharmaceuticals, electronics and spare parts will be made from cheaper, poorer quality materials which will not perform to the same standards as the genuine goods that they seek to imitate.

Counterfeit health products and medicines are especially dangerous as they may lack key ingredients or contain inappropriate substances. Further, they will not be tested to the same rigorous quality and safety control standards; any research and development by the counterfeiters is likely to be limited to efforts to imitate the appearance (but not necessarily the substance) of genuine products.

In July 2012, counterfeit make-up was seized by Trading Standards Officers in Rochdale. These products were totally inferior to genuine make-up. Further, they contained a high amount of lead and were dangerous to users. Similarly, counterfeit make-up seized in Powys in February 2012 was found to contain 20 times the safe, legal amount of lead.

The RAPEX system, which provides alerts for unsafe consumer products inside the EU, contains reports of unsafe counterfeit goods originating from China such as toys containing prohibited chemicals and children's clothes which pose a strangulation risk.

Counterfeit goods are very much a concern in other industries too, such as the electronics and automotive sectors. For example, brake pads made of grass or sawdust have caused fatalities¹. In May 2012 it was reported that counterfeit electronic parts made in China were found in US military aircraft.

PRODUCT LIABILITY IMPLICATIONS

Branding brings benefits to the consumer by providing some assurance as to a product's quality and the manufacturer's accountability. If the counterfeit product is incorrectly identified as being produced by a specific manufacturer (for instance by the logo it bears) and it causes damage, there is a risk that a claim will be made against the innocent manufacturer instead of the counterfeiter.

In such circumstances the innocent manufacturer may be confronted with claims under the Consumer Protection Act 1987, which imposes strict liability upon manufacturers of defective products. A product is

regarded as defective if its safety is not such as persons generally are entitled to expect. The consumer is required to prove that a defect existed and that the alleged defect caused the damage claimed. Similarly, a manufacturer could face a claim in negligence for product defect. Manufacturers owe a duty of care to consumers and are liable for injury or property damage caused by the defect.

In defence to such claims, the manufacturer could plead that it was not the producer of the counterfeit product, but it would need evidence to do so, particularly where the counterfeit is a close imitation. This may involve the manufacturer adducing evidence to compare its product to the counterfeit and instructing experts to prove that the materials and composition are different. In defending a negligence claim, the effect of adducing such evidence would be to deny that the manufacturer owed the consumer a duty of care. A more complex analysis for both the strict liability and negligence claims would be required where the overall product failed as a result of a fake component part.

In any event, responding to and managing such claims is an unwelcome and costly distraction, even if the company eventually succeeds in avoiding liability. For global brands, which are the victim of counterfeiting in multiple jurisdictions, there would be a significant cost in defending product liability claims and taking enforcement action against counterfeiters. This is why it is important to take preventative action.

FIGHTING BACK

Whilst demand for counterfeit goods is likely to remain high because consumers are willing to sacrifice quality for lower price, companies whose products have fallen victim to counterfeiting should be proactive to reduce the damage to the brand.

The in-house lawyer can play a vital role in identifying and addressing risk in the following areas.

Registration of IP rights

The first step is to protect the value in the IP of the brand's products by registering all IP rights, including trademarks, copyrights and patents in all relevant jurisdictions. By vesting exclusive rights in the IP right holder, this is a fundamental step in IP protection so that enforcement action can be taken against infringers in jurisdictions where IP rights are infringed.

Design and production

Manufacturers should review their product lines to identify which items have been counterfeited and those which are susceptible to copying. The aim should be to prevent or substantially reduce imitations. A company's design team should consider how their products can be made harder to replicate. This may also include improving the ability to identify a genuine product through devices such as bar codes that would verify their source as genuine.

Distribution

Companies should also review their supply chains and the path by which their products enter the market. Agreements with distributors should contain appropriate sanctions, which can be invoked if the distributor is in breach. For example, if the distributor cross-contaminates the supply of genuine goods with counterfeit goods, that would be a ground to terminate.

For the legitimate supply routes, the entities involved should be verified and any anomalies and weaknesses in the chain investigated. In particular, authorised retailers should check the provenance of goods.

Attention should be focused on key distribution hubs such as the Free Zones in the UAE where there is less border control and there are known instances of unbranded goods being imported from the Far East and being labelled and packaged as imitation goods. Appropriate action should be taken to stop imitation goods reaching warehouses for onward distribution.

Identification

Brand owners need a strategy to identify and pursue counterfeiters. This is challenging because counterfeiters operate furtively and there are separate informal supply networks whereby imitation goods move undetected from factories to distributors to sellers. To attack these counterfeit networks, test purchases of counterfeit goods should be made from a suspected retailer, and if legal action is brought, disclosure could be sought of other parties in the supply chain. Alternatively, investigators could be hired.

The internet has provided manufacturers of counterfeit goods with access to a global market to sell cheap imitation goods. Therefore, part of the strategy should include monitoring internet activity for sale of imitation goods via online retailer websites and to ascertain if any domain name abuse has occurred.

Enforcement

Once the source of the counterfeiting is identified, proceedings should be brought. Causes of action include passing off, infringement of trademark or patent and breach of copyright.

An enforcement strategy needs to be tailored to the product and the legal remedies available in the jurisdictions involved. For instance, in the Asian economies, enforcement is less effective because there is reportedly a more relaxed approach to counterfeiting. This is predicated by what has been assessed as a cultural tradition that prefers sharing over individual ownership and, as a result, there is less emphasis on rights to protect individual designs. In China, the enforcement of IP rights can be sporadic, with perpetrators regularly escaping serious consequences. For instance, a factory making counterfeit goods may be identified and proceedings brought against the perpetrators. This may result in the closure of the factory, but there is a real risk that it may quickly re-appear and resume its unauthorised manufacturing elsewhere.

CONCLUSION

The more desirable the brand is, the greater the risk that products will be imitated by counterfeiters.

Manufacturing to lower, cheaper standards increases the risk of causing injury or damage, with consequent risks to the company's reputation of being associated with sub-standard or even defective goods.

Where product liability claims are incorrectly filed against the manufacturer, it will be necessary to prove that the products are imitations and a robust anti-counterfeiting strategy will play a vital role in reducing risk and defending any claims which arise.

NOTE

1. Motor & Equipment Manufacturers Association Brand Protection Council: 'Intellectual Property: Protecting Valuable Assets in a Global Market', special report, January 2008.