

**IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION**

GENERAL TOOLS & INSTRUMENTS, LLC,

Plaintiff,

Civil Action No.: 1:20-cv-01036

v.

THE PARTNERSHIPS AND UNINCORPORATED  
ASSOCIATIONS IDENTIFIED ON SCHEDULE “A”,

Defendants.

**COMPLAINT**

Plaintiff, General Tools & Instruments, LLC (“General Tools” or “Plaintiff”), by its undersigned counsel, hereby complains of the Partnerships and Unincorporated Associations identified on Schedule A attached hereto (collectively, “Defendants”), and for its Complaint hereby alleges as follows:

**JURISDICTION AND VENUE**

1. This Court has original subject matter jurisdiction over the claims in this action pursuant to the provisions of the Lanham Act, 15 U.S.C. § 1051 et seq., the Federal Copyright Act, 17 U.S.C. § 101, et seq., 28 U.S.C. § 1338(a)–(b) and 28 U.S.C. § 1331. This Court has jurisdiction over the claims in this action that arise under the laws of the State of Illinois pursuant to 28 U.S.C. § 1367(a), because the state law claims are so related to the federal claims that they form part of the same case or controversy and derive from a common nucleus of operative facts.

2. This Court has personal jurisdiction over each Defendant, in that each Defendant conducts significant business in Illinois and in this Judicial District, and the acts and events giving rise to this lawsuit of which each Defendant stands accused were undertaken in Illinois and in this Judicial District.

3. Venue is proper in this Court pursuant to 28 U.S.C. § 1391, and this Court may properly exercise personal jurisdiction over Defendants since each of the Defendants directly

targets consumers in the United States, including Illinois, through at least the fully interactive commercial Internet stores operating under seller aliases identified in Schedule A attached hereto (collectively, the “Defendant Aliases”). Specifically, Defendants are reaching out to do business with Illinois residents by operating one or more commercial, interactive Internet stores through which Illinois residents can purchase products bearing infringing and/or counterfeit versions of Plaintiff’s products. Each of the Defendants has targeted sales from Illinois residents by operating online stores that offer shipping to the United States, including Illinois, accept payment in U.S. dollars and, on information and belief, has sold products that infringe Plaintiff’s trademarks and/or copyrights to residents of Illinois. Each of the Defendants is committing tortious acts in Illinois, is engaging in interstate commerce, and has wrongfully caused Plaintiff substantial injury in the State of Illinois.

### **INTRODUCTION**

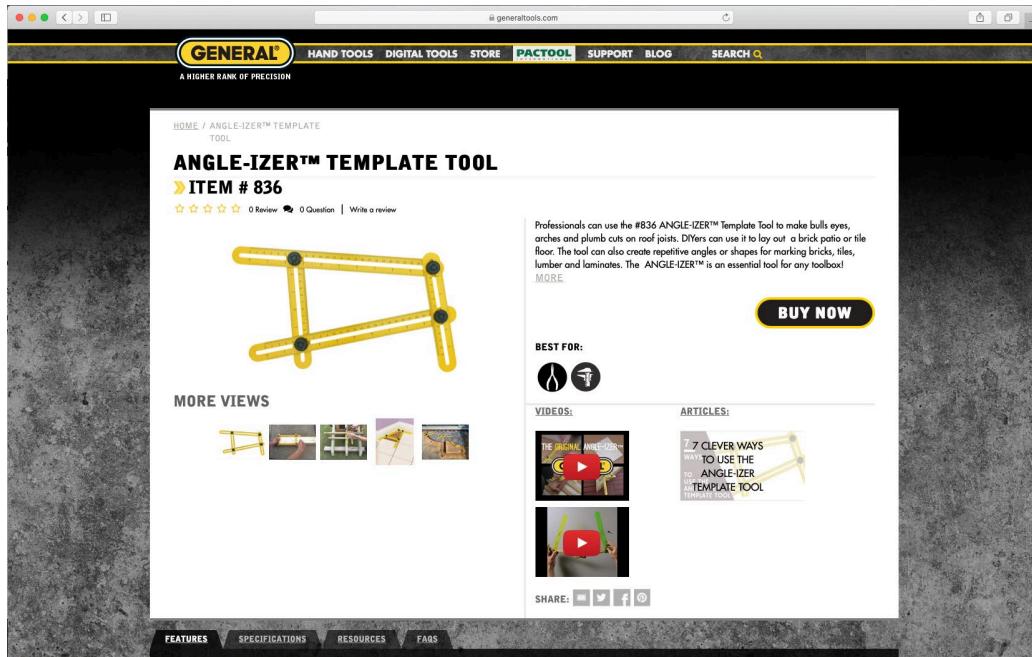
4. This action has been filed by Plaintiff to combat online trademark and copyright infringers who trade upon Plaintiff’s valuable trademarks and copyrights by selling and/or offering for sale products hereinafter referred to as the “ANGLE-IZER Products.”

5. General Tool’s ANGLE-IZER Products are used and recognized as a symbol of adjustable templates for use in measuring tiles, bricks, and construction materials for cutting purposes, and computer programs for use in calculating custom dimensions of tiles, bricks, and construction materials sold therein.

6. The ANGLE-IZER Marks Products been widely promoted, both in the United States and throughout the world. Consumers, potential customers, and other members of the public and the tool and construction industries not only associate Plaintiff’s products with exceptional materials, style and workmanship, but also recognize the Plaintiff’s products sold in the United States originate exclusively with Plaintiff.

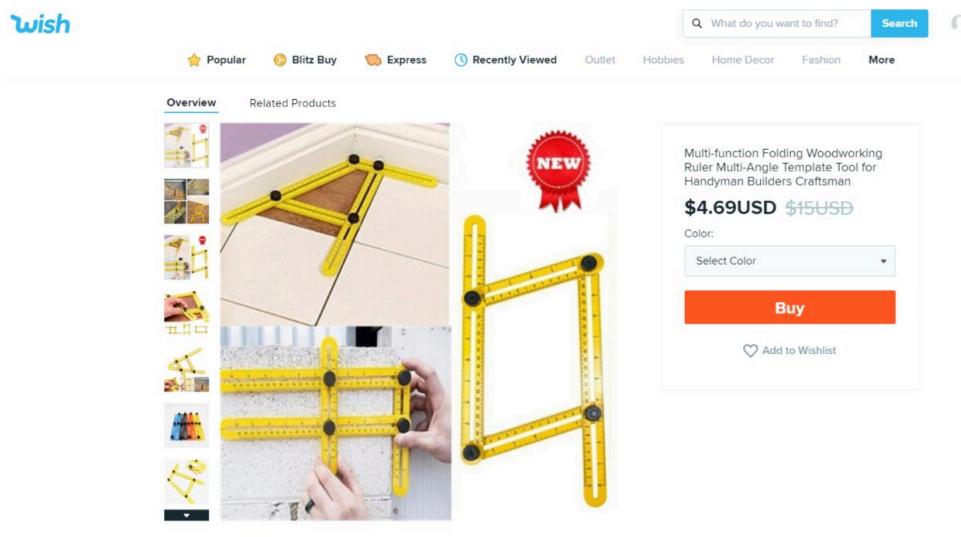
7. Below is a link and the screenshot of where General Tools' authentic ANGLE-IZER Products can be purchased from, versus the counterfeiters selling the illegal product at prices substantially below an original:

### ORIGINAL



<https://www.generaltols.com/angle-izer-template-tool>

### COUNTERFEIT



8. The above example of one of the Defendant Aliases on the WISH platform evidences a cooperative counterfeiting network using fake eCommerce store fronts designed to appear to be selling authorized products. To be able to offer the counterfeit products at a price substantially below the cost of original, while still being able to turn a profit after absorbing the cost of manufacturing, advertising and shipping requires an economy of scale only achievable through a cooperative effort throughout the supply chain. As Homeland Security's recent report confirms, counterfeiters act in concert through coordinated supply chains and distribution networks to unfairly compete with legitimate brand owners while generating huge profits for the illegal counterfeiting network:

Historically, many counterfeits were distributed through swap meets and individual sellers located on street corners. **Today, counterfeits are being trafficked through vast e-commerce supply chains in concert with marketing, sales, and distribution networks.** The ability of e-commerce platforms to aggregate information and reduce transportation and search costs for consumers provides a big advantage over brick-and-mortar retailers. Because of this, sellers on digital platforms have consumer visibility well beyond the seller's natural geographical sales area.

...

The impact of counterfeit and pirated goods is broader than just unfair competition. Law enforcement officials have uncovered intricate links between the sale of counterfeit goods and transnational organized crime. **A study by the Better Business Bureau notes that the financial operations supporting counterfeit goods typically require central coordination,** making these activities attractive for organized crime, with groups such as the Mafia and the Japanese Yakuza heavily involved. Criminal organizations use coerced and child labor to manufacture and sell counterfeit goods. In some cases, the proceeds from counterfeit sales may be supporting terrorism and dictatorships throughout the world.

...

Selling counterfeit and pirated goods through e-commerce is a highly profitable activity: production costs are low, millions of potential customers are available online, transactions are convenient, and listing on well-branded e-commerce platforms provides an air of legitimacy.

*See, Department of Homeland Security, Combating Trafficking in Counterfeit and Pirated Goods, Jan. 24, 2020, (<https://www.dhs.gov/publication/combatting-trafficking-counterfeit-and-pirated-goods>), at 10, 19 (emphasis added) attached hereto as Exhibit 1.*

9. The Defendant Aliases share unique identifiers, such as design elements and similarities of the unauthorized products offered for sale, establishing a logical relationship between them and suggesting that Defendants' illegal operations arise out of the same transaction, occurrence, or series of transactions or occurrences. Defendants use aliases to avoid liability by going to great lengths to conceal both their identities as well as the full scope and interworking of their illegal network. Despite deterrents such as take downs and other measures, the use of aliases enables counterfeiters to stymie authorities:

The scale of counterfeit activity online is evidenced as well by the significant efforts e-commerce platforms themselves have had to undertake. A major e-commerce platform reports that its proactive efforts prevented over 1 million suspected bad actors from publishing a single product for sale through its platform and blocked over 3 billion suspected counterfeit listings from being published to their marketplace. Despite efforts such as these, private sector actions have not been sufficient to prevent the importation and sale of a wide variety and large volume of counterfeit and pirated goods to the American public.

A counterfeiter seeking to distribute fake products will typically set up one or more accounts on online third-party marketplaces. The ability to rapidly proliferate third-party online marketplaces greatly complicates enforcement efforts, especially for intellectual property rights holders. Rapid proliferation also allows counterfeiters to hop from one profile to the next even if the original site is taken down or blocked. On these sites, online counterfeiters can misrepresent products by posting pictures of authentic goods while simultaneously selling and shipping counterfeit versions.

Not only can counterfeiters set up their virtual storefronts quickly and easily, but they can also set up new virtual storefronts when their existing storefronts are shut down by either law enforcement or through voluntary initiatives set up by other stakeholders such as market platforms, advertisers, or payment processors.

*Id.* at 5, 11, 12.

10. eCommerce giant Alibaba has also made public its efforts to control counterfeiting on its platform. It formed a special task force that worked in conjunction with Chinese authorities for a boots-on-the-ground effort in China to stamp out counterfeiters. In describing the counterfeiting networks it uncovered, Alibaba expressed its frustration in dealing with "vendors, affiliated dealers and factories" that rely upon

fictitious identities that enable counterfeiting rings to play whack-a-mole with authorities:

## Fighting China's counterfeits in the online era

Xinhua | Updated: 2017-09-19 14:20

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BEIJING - A secret team in Chinese e-commerce giant Alibaba has the task of pretending to be online consumers who test-buy purchases from the billion-plus products on its platforms.

Alibaba's Anti-Counterfeiting Special Task Force, formed last year, actively works with local law enforcement agencies, said Qin Seng.

"After we clean up online shops selling counterfeits, the counterfeiters usually change their identities and places of dispatch, using more covert means to continue selling online," Qin said.

The team uses big data to identify counterfeits and the vendors, affiliated dealers and factories suspected of producing or selling counterfeit items. They pass evidence to the public security, administration of commerce and industry, quality inspection, food and drug supervision and other law enforcement agencies. At the same time, they investigate the evidence in the field.

The team faces many risks in their offline probes.

"Most counterfeiting dens are hidden and well-organized. For example, we encountered a village producing counterfeits. The villagers installed cameras everywhere and when they saw outsiders entering, they became vigilant and even threatened us," Qin said.

*See Xinhua, Fighting China's Counterfeits in the Online Era, China Daily (Sept. 19, 2017),*

available at [www.chinadaily.com.cn/business/2017-09/19/content\\_32200290.htm](http://www.chinadaily.com.cn/business/2017-09/19/content_32200290.htm) (**Exhibit 2**)

11. Plaintiff has been and continues to be irreparably damaged through consumer confusion, dilution, loss of control over its reputation and good-will as well as the quality of goods bearing the trademarks and copyrighted images. The rise of eCommerce as a method of supplying goods to the public exposes brand holders and creators that make significant investments in their products to significant harm from counterfeiters:

Counterfeiting is no longer confined to street-corners and flea markets. The problem has intensified to staggering levels, as shown by a recent Organisation for Economic Cooperation and Development (OECD) report, which details a 154 percent increase in counterfeits traded internationally — from \$200 billion in 2005 to \$509 billion in 2016. Similar information collected by the U.S. Department of

Homeland Security (DHS) between 2000 and 2018 shows that seizures of infringing goods at U.S. borders have increased 10-fold, from 3,244 seizures per year to 33,810.

...

The rise in consumer use of third-party marketplaces significantly increases the risks and uncertainty for U.S. producers when creating new products. It is no longer enough for a small business to develop a product with significant local consumer demand and then use that revenue to grow the business regionally, nationally, and internationally with the brand protection efforts expanding in step. Instead, with the international scope of e-commerce platforms, once a small business exposes itself to the benefits of placing products online — which creates a geographic scope far greater than its more limited brand protection efforts can handle — it begins to face increased foreign infringement threat.

...

Moreover, as costs to enter the online market have come down, such market entry is happening earlier and earlier in the product cycle, further enhancing risk. If a new product is a success, counterfeiters will attempt, often immediately, to outcompete the original seller with lower-cost counterfeit and pirated versions while avoiding the initial investment into research and design.

...

Counterfeiters have taken full advantage of the aura of authenticity and trust that online platforms provide. While e-commerce has supported the launch of thousands of legitimate businesses, their models have also enabled counterfeiters to easily establish attractive “store-fronts” to compete with legitimate businesses.

*See, Combating Trafficking in Counterfeit and Pirated Goods, Jan. 24, 2020, (Exhibit 1) at 4, 8, 11.*

12. Not only are the creators and brand holders harmed, the public is harmed as well:

The rapid growth of e-commerce has revolutionized the way goods are bought and sold, allowing for counterfeit and pirated goods to flood our borders and penetrate our communities and homes. Illicit goods trafficked to American consumers by e-commerce platforms and online third-party marketplaces threaten public health and safety, as well as national security. This illicit activity impacts American innovation and erodes the competitiveness of U.S. manufacturers and workers. P3

The President’s historic memorandum provides a much warranted and long overdue call to action in the U.S. Government’s fight against a massive form of illicit trade that is inflicting significant harm on American consumers and businesses. This illicit trade must be stopped in its tracks.

*Id.* at 4. (Underlining in original)

13. Plaintiff's investigation shows that the telltale signs of an illegal counterfeiting network are at work in the instant action. For example, the online storefront names set forth in Schedule A employ no normal business nomenclature and, instead, have the appearance of being made up. Thus, the Defendant Aliases are using fake online storefronts designed to appear to be selling genuine products, while selling inferior imitations of Plaintiff's products. It is also no coincidence that the counterfeit products at issue bear similarities in cost and design another sign of a counterfeiting network in action. The Defendants operate as a concerted network of counterfeiters operating on eCommerce sites such as Amazon, eBay, Wish and, Alibaba. Plaintiff is forced to file this action to combat Defendants' counterfeiting of Plaintiff's registered trademarks and copyrights, as well as to protect unknowing consumers from purchasing unauthorized products over the Internet.

#### **THE PLAINTIFF**

14. Plaintiff, General Tools & Instruments, LLC ("General Tools") is a Limited Liability Company organized under New York law. General Tools maintains its principal place of business at 75 Seaview Drive Secaucus, New Jersey 07094.

15. This action has been filed by Plaintiff to combat online counterfeiter Solid Value who trade upon Plaintiff's reputation and goodwill by selling and/or offering for sale products in connection with Plaintiff's ANGLE-IZER trademarks, which are covered by U.S. Trademark Registration U.S. Reg. No. 5,345,751 and U.S. Reg. Nos. 5,345,752 (the "ANGLE-IZER Trademarks"). A true and correct copy of the federal trademark registration certificates for the marks is attached hereto as **Exhibit 3**. Plaintiff is the owner of Copyright Registration Nos. VA0002183652; VA0002183717 (the "ANGLE-IZER Works"). A true and correct copy of the federal copyright registration records is attached hereto as **Exhibit 4**.

16. The ANGLE-IZER Trademarks are distinctive and identify the source of the merchandise as goods sold by the Plaintiff. The ANGLE-IZER Trademarks registrations constitute *prima facie* evidence of their validity, and of Plaintiff's exclusive right to use the ANGLE-IZER Trademarks pursuant to 15 U.S.C. § 1057 (b). The ANGLE-IZER Trademarks have been continuously used and never abandoned.

17. Since the initial launch of its original ANGLE-IZER family of measuring tools, the ANGLE-IZER Trademarks and Works have been the subject of substantial and continuous marketing and promotion by the Plaintiff, both in the United States and throughout the world. Plaintiff has and continues to widely market and promote its ANGLE-IZER Trademarks in the industry and to customers, and, as of the date of this filing, Plaintiff's Products are sold throughout the nation at various national and local retail outlets and hardware chains (e.g., The Home Depot, Walmart, Ace Hardware, Lowes, etc.), as noted on Plaintiff's primary website located at [www.generaltools.com](http://www.generaltools.com).

18. Plaintiff maintains quality control standards for all ANGLE-IZER Products, and the ANGLE-IZER Trademarks and Works are a highly visible and a distinctive worldwide symbol of excellent quality products, uniquely associated with the Plaintiff and, as a result, Plaintiff Products bearing the ANGLE-IZER Trademarks have generated millions of dollars in revenue over the years.

19. Customers recognize that products bearing the distinctive ANGLE-IZER Trademarks originate exclusively with the Plaintiff. The ANGLE-IZER Trademarks registrations constitute *prima facie* evidence of its validity, and of Plaintiff's exclusive right to use the ANGLE-IZER trademarks pursuant to 15 U.S.C. § 1057 (b) and art works pursuant to 17 U.S.C. § 101.

### **THE DEFENDANTS**

20. Defendants are individuals and business entities who, upon information and belief, reside in the People's Republic of China or other foreign jurisdictions. Defendants conduct business throughout the United States, including within Illinois and in this Judicial District, through the operation of the fully interactive commercial websites and online marketplaces operating under the Defendant Aliases. Each Defendant targets the United States, including Illinois, and has offered to sell and, on information and belief, has sold and continues to sell counterfeit and infringing ANGLE-IZER products to consumers within the United States, including Illinois and in this Judicial District.

### **THE DEFENDANTS' UNLAWFUL CONDUCT**

21. The success of the ANGLE-IZER Products has resulted in significant counterfeiting and infringement. Plaintiff has identified numerous marketplace listings on eCommerce platforms such as, but not limited to, eBay, WISH, Amazon, Tophatter, Walmart, Aliexpress, and Alibaba, including the Defendant Aliases, which have been offering for sale, selling, and importing illegal products to consumers in this Judicial District and throughout the United States. Defendants have persisted in creating the Defendant Aliases. eCommerce sales, including eCommerce Internet stores like those of Defendants, have resulted in a sharp increase in the shipment of unauthorized products into the United States. *See Exhibit 5*, Department of Homeland Security, *Fiscal Year 2018 Seizure Statistics Report*. According to Customs and Border Patrol's ("CBP") report, over 90% of all CBP intellectual property seizures were smaller international mail and express shipments (as opposed to large shipping containers). *Id.* Over 85% of CBP seizures originated from mainland China and Hong Kong. *Id.* Counterfeit and pirated products account for billions in economic losses, resulting in tens of thousands of lost jobs for

legitimate businesses and broader economic losses, including lost tax revenue.

22. Counterfeiting rings are able to take advantage of the anonymity provided by the Internet which allows them to evade enforcement efforts to combat counterfeiting. For example, counterfeiters take advantage of the fact that marketplace platforms do not adequately subject new sellers to verification and confirmation of their identities, allowing counterfeiters to “routinely use false or inaccurate names and addresses when registering with these Internet platforms.” **Exhibit 6**, Daniel C.K. Chow, *Alibaba, Amazon, and Counterfeiting in the Age of the Internet*, 41 Nw. J. INT’L L. & BUS. 24 (forthcoming 2020). Further, “Internet commerce platforms create bureaucratic or technical hurdles in helping brand owners to locate or identify sources of counterfeits and counterfeiters.” *Id.* at 25. This lack of meaningful regulation allows the Defendants to garner sales from Illinois residents by setting up and operating eCommerce Internet stores that target United States consumers using one or more seller aliases, offer shipping to the United States, including Illinois, accept payment in U.S. dollars and, on information and belief, have sold counterfeit products to residents of Illinois.

23. Shrouding their counterfeiting operation in anonymity allows the defendants to operate as a ring of counterfeiters operating on eCommerce sites such as WISH, eBay and, Alibaba. Plaintiff’s investigation shows that the telltale signs of an illegal counterfeiting ring are present in the instant action. For example, the online storefront names set forth in Schedule A employ unconventional nomenclature designed to conceal identifying information of the true owner. Instead, the seller names appear to be made up aliases. Thus, the Defendant Aliases are using fake online storefronts designed to appear to be selling genuine Plaintiff products, while selling inferior imitations of Plaintiff’s products.

24. Another telltale sign of a mutually cooperative counterfeiting ring in operation is that,

on information and belief, Defendants regularly register or acquire new seller aliases for the purpose of offering for sale and selling counterfeit products. Such seller alias registration patterns are one of many common tactics used by the Defendants to conceal their identities, the full scope and interworking of their counterfeiting operation, and to avoid being shut down.

25. On information and belief, the level of cooperation between the Defendants is so significant that they are in constant communication with each other and regularly participate in all kinds of online private chat rooms and through websites such as sellerdefense.cn regarding tactics for operating multiple accounts, evading detection, pending litigation, and potential new lawsuits.

26. Upon information and belief, Defendants facilitate sales by concurrently employing and benefitting from substantially similar advertising and marketing strategies as well as by designing the Defendant Aliases so that they appear to unknowing consumers to be authorized online retailers, outlet stores, or wholesalers selling genuine ANGLE-IZER products. Many of the Defendant Aliases look sophisticated and accept payment in U.S. dollars via credit cards, Western Union and PayPal. Defendant Aliases often include images and design elements that make it very difficult for consumers to distinguish such unauthorized sites from an authorized website. Defendants further perpetuate the illusion of legitimacy by offering “live 24/7” customer service and using indicia of authenticity and security that consumers have come to associate with authorized retailers, including the McAfee® Security, VeriSign®, Visa®, MasterCard®, and PayPal® logos. Plaintiff has not licensed or authorized Defendants to use the ANGLE-IZER Trademarks and Copyrights.

27. Upon information and belief, at all times relevant hereto, the Defendants in this action have had full knowledge of Plaintiff’s ownership of the ANGLE-IZER Trademarks and Works, including its exclusive right to use and license such intellectual property and the goodwill associated

therewith. Defendant factory provides product with ANGLE-IZER Trademarks on the products, the packaging, and even supplies instructions to be used to sell counterfeit products, see screenshot from Defendants' Online Stores below:



28. Defendants go to great lengths to conceal their identities and often use multiple fictitious names and addresses to register and operate their massive network of Defendant Aliases. Upon information and belief, Defendants regularly create new online marketplace accounts on various platforms using the identities listed in Schedule A of the Complaint, as well as other unknown fictitious names and addresses. Such Defendant Alias registration patterns are one of many common tactics used by the Defendants to conceal their identities, the full scope and interworking of their massive infringing operation, and to avoid being shut down.

29. Even though Defendants operate under multiple fictitious names, there are numerous similarities among the Defendant Aliases. For example, many of the Defendant Aliases have virtually identical layouts. In addition, many of the unauthorized ANGLE-IZER products for sale in the Defendant Aliases bear similarities and indicia of being related to one another, suggesting that the illegal products were manufactured by and come from a common source and that, upon information and belief, Defendants are interrelated. Such commonalities include incomplete logos, improper spelling and other written materials.

30. The Defendant Aliases also include other notable common features, including lack of contact information, identically or similarly priced items and volume sales discounts, similar hosting services, similar name servers, and the use of the same text and images.

31. Further, illegal operators such as Defendants typically operate multiple credit card merchant accounts and third-party accounts, such as PayPal, Inc. accounts, (collectively “PayPal”), behind layers of payment gateways so that they can continue operation in spite of any enforcement efforts. Upon information and belief, Defendants maintain off-shore bank accounts and regularly move funds from their PayPal accounts to off-shore bank accounts outside the jurisdiction of this Court. Indeed, analysis of PayPal transaction logs from previous similar cases indicates that offshore operators regularly move funds from U.S.-based PayPal accounts to China-based bank accounts outside the jurisdiction of this Court.

**COUNT I**  
**TRADEMARK INFRINGEMENT AND COUNTERFEITING (15 U.S.C. § 1114)**

32. Plaintiff repleads and incorporates by reference each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

33. This is a trademark infringement action against Defendants based on their unauthorized use in commerce of counterfeit imitations of the registered ANGLE-IZER Trademarks in connection with the sale, offering for sale, distribution, and/or advertising of infringing goods. The ANGLE-IZER Trademarks are highly distinctive marks. Consumers have come to expect the highest quality from Plaintiff’s products provided under the ANGLE-IZER Trademarks.

34. Defendants have sold, offered to sell, marketed, distributed, and advertised, and are still selling, offering to sell, marketing, distributing, and advertising products in connection with the ANGLE-IZER Trademarks without Plaintiff’s permission.

35. Plaintiff is the exclusive owner of the ANGLE-IZER Trademarks. Plaintiff's United States Registration for the ANGLE-IZER Trademarks (**Exhibit 3**) is in full force and effect. Upon information and belief, Defendants have knowledge of Plaintiff's rights in the ANGLE-IZER Trademarks and are willfully infringing and intentionally using counterfeits of the ANGLE-IZER Trademarks. Defendants' willful, intentional and unauthorized use of the ANGLE-IZER Trademarks are likely to cause and is causing confusion, mistake, and deception as to the origin and quality of the counterfeit goods among the general consuming public.

36. Defendants' activities constitute willful trademark infringement and counterfeiting under Section 32 of the Lanham Act, 15 U.S.C. § 1114.

37. Plaintiff has no adequate remedy at law, and if Defendants' actions are not enjoined, Plaintiff will continue to suffer irreparable harm to its reputation and the goodwill of its well-known ANGLE-IZER Trademarks.

38. The injuries and damages sustained by Plaintiff have been directly and proximately caused by Defendants' wrongful reproduction, use, advertisement, promotion, offering to sell, and sale of counterfeit ANGLE-IZER products.

**COUNT II**  
**FALSE DESIGNATION OF ORIGIN (15 U.S.C. § 1125(a))**

39. Plaintiff repleads and incorporates by reference each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

40. Defendants' promotion, marketing, offering for sale, and sale of infringing and counterfeit ANGLE-IZER products has created and is creating a likelihood of confusion, mistake, and deception among the general public as to the affiliation, connection, or association with Plaintiff or the origin, sponsorship, or approval of Defendants' counterfeit ANGLE-IZER products by Plaintiff.

41. By using the ANGLE-IZER Trademarks in connection with the sale of counterfeit ANGLE-IZER products, Defendants create a false designation of origin and a misleading representation of fact as to the origin and sponsorship of the counterfeit ANGLE-IZER products.

42. Defendants' false designation of origin and misrepresentation of fact as to the origin and/or sponsorship of the counterfeit ANGLE-IZER products to the general public is a willful violation of Section 43 of the Lanham Act, 15 U.S.C. § 1125.

43. Plaintiff has no adequate remedy at law and, if Defendants' actions are not enjoined, Plaintiff will continue to suffer irreparable harm to its reputation and the goodwill of its brand.

**COUNT III**  
**VIOLATION OF ILLINOIS UNIFORM DECEPTIVE TRADE PRACTICES ACT (815**  
**ILCS § 510, et seq.)**

44. Plaintiff repleads and incorporates by reference each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

45. Defendants have engaged in acts violating Illinois law including, but not limited to, passing off their counterfeit ANGLE-IZER products as those of Plaintiff, causing a likelihood of confusion and/or misunderstanding as to the source of their goods, causing a likelihood of confusion and/or misunderstanding as to an affiliation, connection, or association with genuine ANGLE-IZER products, representing that their products have Plaintiff's approval when they do not, and engaging in other conduct which creates a likelihood of confusion or misunderstanding among the public.

46. The foregoing Defendants' acts constitute a willful violation of the Illinois Uniform Deceptive Trade Practices Act, 815 ILCS § 510, et seq.

47. Plaintiff has no adequate remedy at law, and Defendants' conduct has caused Plaintiff to suffer damage to its reputation and goodwill. Unless enjoined by the Court, Plaintiff

will suffer future irreparable harm as a direct result of Defendants' unlawful activities.

**COUNT IV**  
**COPYRIGHT INFRINGEMENT 17 U.S.C. § 501(a)**

48. Plaintiff repleads and incorporates by reference each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

49. The ANGLE-IZER Works have significant value and have been produced and created at considerable expense. Plaintiff is the owner of each of the original works, which are covered by Copyright Registrations. (**Exhibit 4**)

50. Plaintiff, at all relevant times, has been the holder of the pertinent exclusive rights infringed by Defendants, as alleged hereunder, including but not limited to the copyrighted ANGLE-IZER Works, including derivative works.

51. Upon information and belief, Defendants had access to the works through Plaintiff's normal business activities. After accessing Plaintiff's work, Defendants wrongfully created copies of the copyrighted ANGLE-IZER Works without Plaintiff's consent and engaged in acts of widespread infringement through posting the works via online websites and digital markets, and the creation and sale of prints.

52. General Tools is informed and believes and thereon alleges that Defendants further infringed General Tools' copyrights by making or causing to be made derivative works from the ANGLE-IZER Works by producing and distributing reproductions without General Tools' permission.

53. Defendants, without the permission or consent of the Plaintiff, have, and continue to sell online infringing derivative works of the copyrighted ANGLE-IZER Works. Defendants have violated Plaintiff's exclusive rights of reproduction and distribution. Defendants actions constitute an infringement of Plaintiff's exclusive rights protected under the Copyright Act (17

U.S.C. §101 et seq.).

54. Further, as a direct result of the acts of copyright infringement, Defendants have obtained direct and indirect profits they would not otherwise have realized but for their infringement of the copyrighted ANGLE-IZER Works. General Tools is entitled to disgorgement of Defendants' profits directly and indirectly attributable to their infringement of the ANGLE-IZER Works.

55. The foregoing acts of infringement constitute a collective enterprise of shared, overlapping facts and have been willful, intentional, and in disregard of and with indifference to the rights of the Plaintiff.

56. As a result of Defendants' infringement of Plaintiff's exclusive rights under copyrights, Plaintiff is entitled to relief pursuant to 17 U.S.C. §504.

57. The conduct of Defendants is causing and, unless enjoined and restrained by this Court, will continue to cause Plaintiff great and irreparable injury that cannot fully be compensated or measured in money. Plaintiff has no adequate remedy at law. Pursuant to 17 U.S.C. §§502 and 503, Plaintiff is entitled to injunctive relief prohibiting Defendants from further infringing Plaintiff's copyright and ordering that Defendants destroy all unauthorized copies. Defendants' copies, plates, and other embodiment of ANGLE-IZER Works from which copies can be reproduced should be impounded and forfeited to General Tools as instruments of infringement, and all infringing copies created by Defendants should be impounded and forfeited to General Tools, under 17 U.S.C §503.

COUNT V  
CIVIL CONSPIRACY

58. Plaintiff repleads and incorporates by reference each and every allegation set forth in the preceding paragraphs as if fully set forth herein.

59. Plaintiff is informed and believe and thereon allege that Defendants knowingly and voluntarily entered into a scheme and agreement to engage in a combination of unlawful acts and misconduct including, without limitation, a concerted and collaborated effort to maintain the distribution, marketing, advertising, shipping, offering for sale, or sale of fake ANGLE-IZER Products in violation of the Illinois Uniform Deceptive Trade Practices Act, 815 ILCS § 510, et seq.

60. The intent, purpose and objective of the conspiracy and the underlying combination of unlawful acts and misconduct committed by the Defendants was to undermine General Tools and its business by unfairly competing against it as described above.

61. The Defendants each understood and accepted the foregoing scheme and agreed to do their respective part, to further accomplish the foregoing intent, purpose and objective. Thus, by entering into the conspiracy, each Defendant has deliberately, willfully and maliciously permitted, encouraged, and/or induced all of the foregoing unlawful acts and misconduct.

62. As a direct and proximate cause of the unlawful acts and misconduct undertaken by each Defendant in furtherance of the conspiracy, General Tools has sustained, and unless each Defendant is restrained and enjoined, will continue to sustain severe, immediate and irreparable harm, damage and injury for which General Tools has no adequate remedy at law.

#### **PRAYER FOR RELIEF**

WHEREFORE, Plaintiff prays for judgment against Defendants as follows:

- 1) That Defendants, their affiliates, officers, agents, servants, employees, attorneys, confederates, and all persons acting for, with, by, through, under, or in active concert with them be temporarily preliminarily, and permanently enjoined and restrained from:
  - a. using the ANGLE-IZER Trademarks and Works in any manner in connection

with the distribution, marketing, advertising, offering for sale, or sale of any product that is not a genuine ANGLE-IZER product, or is not authorized by Plaintiff to be sold in connection with the ANGLE-IZER Trademarks and Works;

- b. passing off, inducing, or enabling others to sell or pass off any product as a genuine ANGLE-IZER product or any other product produced by Plaintiff that is not Plaintiff's or not produced under the authorization, control, or supervision of Plaintiff and approved by Plaintiff for sale under the ANGLE-IZER Trademarks and associated with or derived from the ANGLE-IZER Works;
- c. committing any acts calculated to cause consumers to believe that Defendants' counterfeit ANGLE-IZER products are those sold under the authorization, control, or supervision of Plaintiff, or are sponsored by, approved by, or otherwise connected with Plaintiff;
- d. further infringing the ANGLE-IZER Trademarks and Works and damaging Plaintiff's goodwill;
- e. otherwise competing unfairly with Plaintiff in any manner;
- f. shipping, delivering, holding for sale, transferring or otherwise moving, storing, distributing, returning, or otherwise disposing of, in any manner, products or inventory not manufactured by or for Plaintiff, nor authorized by Plaintiff to be sold or offered for sale, and which bear any ANGLE-IZER Trademarks, or any reproductions, counterfeit copies, or colorable imitations thereof;
- g. using, linking to, transferring, selling, exercising control over, or otherwise owning the Online Marketplace Accounts, or any other domain name or online

marketplace account that is being used to sell or is the means by which Defendants could continue to sell counterfeit ANGLE-IZER products; and

2) That Defendants, within fourteen (14) days after service of judgment with notice of entry thereof upon them, be required to file with the Court and serve upon Plaintiff a written report under oath setting forth in detail the manner and form in which Defendants have complied with paragraph 1, a through g, above;

3) Entry of an Order that, upon Plaintiff's request, those in privity with Defendants and those with notice of the injunction, including any online marketplaces such as Amazon and Alibaba Group Holding Ltd., Alipay.com Co., Ltd. and any related Alibaba entities (collectively, "Alibaba"), social media platforms, Facebook, YouTube, LinkedIn, Twitter, Internet search engines such as Google, Bing and Yahoo, web hosts for the Defendant Domain Names, and domain name registrars, shall:

- a. disable and cease providing services for any accounts through which Defendants engage in the sale of counterfeit ANGLE-IZER products using the ANGLE-IZER Trademarks, including any accounts associated with the Defendants listed on Schedule A;
- b. disable and cease displaying any advertisements used by or associated with Defendants in connection with the sale of counterfeit and infringing ANGLE-IZER products using the ANGLE-IZER Trademarks and Works; and
- c. take all steps necessary to prevent links to the Defendant Online Stores identified on Schedule A from displaying in search results, including, but not limited to, removing links to the Defendant Online Stores from any search index; and

- 4) That Defendants account for and pay to Plaintiff all profits realized by Defendants by reason of Defendants' unlawful acts herein alleged, and that the amount of damages for infringement of the ANGLE-IZER Trademarks be increased by a sum not exceeding three times the amount thereof as provided by 15 U.S.C. § 1117;
- 5) For Judgment in favor of Plaintiffs against Defendants that they have: a) willfully infringed Plaintiffs' rights in its federally registered copyright pursuant to 17 U.S.C. §501; and b) otherwise injured the business reputation and business of Plaintiffs by Defendants' acts and conduct set forth in this Complaint;
- 6) For Judgment in favor of Plaintiffs against Defendants for actual damages or statutory damages pursuant to 17 U.S.C. §504, at the election of Plaintiffs, in an amount to be determined at trial;
- 7) In the alternative, that Plaintiff be awarded statutory damages pursuant to 15 U.S.C. § 1117(c)(2) of \$2,000,000 for each and every use of the ANGLE-IZER Trademarks;
- 8) That Plaintiff be awarded its reasonable attorneys' fees and costs; and
- 9) Award any and all other relief that this Court deems just and proper.

DATED: February 12, 2020

Respectfully submitted,

*/s/ Keith A. Vogt*  
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*ATTORNEY FOR PLAINTIFF*

# Exhibit 1



# Combating Trafficking in Counterfeit and Pirated Goods

Report to the President of the United States

*January 24, 2020*



Homeland  
Security

*Office of Strategy, Policy & Plans*

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## Foreword/Message from the Acting Secretary of Homeland Security

The rapid growth of e-commerce has revolutionized the way goods are bought and sold, allowing for counterfeit and pirated goods to flood our borders and penetrate our communities and homes. Illicit goods trafficked to American consumers by e-commerce platforms and online third-party marketplaces threaten public health and safety, as well as national security. This illicit activity impacts American innovation and erodes the competitiveness of U.S. manufacturers and workers.

Consumers must be confident in the safety, quality, and authenticity of the products they purchase online. DHS is committed to combating counterfeiters and pirates with the help of our U.S. Government partners and private sector stakeholders - who are critical to helping secure supply chains to stem the tide of counterfeit and pirated goods.



“Combating Trafficking in Counterfeit and Pirated Goods,” has been prepared by the U.S. Department of Homeland Security’s Office of Strategy, Policy, and Plans. The report uses available data, substantial public input, and other information to develop a deeper understanding of how e-commerce platforms, online third-party marketplaces, and other third-party intermediaries facilitate the importation and sale of massive amounts of counterfeit and pirated goods. The report identifies appropriate administrative, statutory, regulatory, and other actions, including enhanced enforcement measures, modernization of legal and liability frameworks, and best practices for private sector stakeholders. These strong actions can be implemented swiftly to substantially reduce trafficking in counterfeit and pirated goods while promoting a safer America.

This report was prepared pursuant to President Donald J. Trump’s April 3, 2019, *Memorandum on Combating Trafficking in Counterfeit and Pirated Goods*. The President’s historic memorandum provides a much warranted and long overdue call to action in the U.S. Government’s fight against a massive form of illicit trade that is inflicting significant harm on American consumers and businesses. This illicit trade must be stopped in its tracks.

This report was prepared in coordination with the Secretaries of Commerce and State, the Attorney General, the Office of Management and Budget, the Intellectual Property Enforcement Coordinator, the United States Trade Representative, the Assistant to the President for Economic Policy, the Assistant to the President for Trade and Manufacturing Policy, and with other partners in the U.S. Government. The report also benefitted from extensive engagement with the private sector.

Sincerely,

Chad Wolf  
Acting Secretary,  
U.S. Department of Homeland Security

## 1. Executive Summary

The President’s April 3, 2019, *Memorandum on Combating Trafficking in Counterfeit and Pirated Goods* calls prompt attention to illicit trade that erodes U.S. economic competitiveness and catalyzes compounding threats to national security and public safety.

Counterfeiting is no longer confined to street-corners and flea markets. The problem has intensified to staggering levels, as shown by a recent Organisation for Economic Cooperation and Development (OECD) report, which details a 154 percent increase in counterfeits traded internationally — from \$200 billion in 2005 to \$509 billion in 2016. Similar information collected by the U.S. Department of Homeland Security (DHS) between 2000 and 2018 shows that seizures of infringing goods at U.S. borders have increased 10-fold, from 3,244 seizures per year to 33,810.

Relevant to the President’s inquiry into the linkages between e-commerce and counterfeiting, OECD reports that “E-commerce platforms represent ideal storefronts for counterfeits and provide powerful platform[s] for counterfeiters and pirates to engage large numbers of potential consumers.”<sup>1</sup> Similarly, the U.S. Government Accountability Office (GAO) found that e-commerce has contributed to a shift in the sale of counterfeit goods in the United States, with consumers increasingly purchasing goods online and counterfeiters producing a wider variety of goods that may be sold on websites alongside authentic products.

Respondents to the July 10, 2019, Federal Register Notice issued by the Department of Commerce echoed these observations.<sup>2</sup> Perhaps most notably, the International Anti-Counterfeiting Coalition (IACC) reports that the trafficking of counterfeit and pirated goods in e-commerce is a top priority for every sector of its membership — comprised of more than 200 corporations, including many of the world’s best-known brands in the apparel, automotive, electronics, entertainment, luxury goods, pharmaceutical, personal care and software sectors. The IACC submission goes on to say:

*Across every sector of the IACC’s membership, the need to address the trafficking of counterfeit and pirated goods in e-commerce has been cited as a top priority. The vast amounts of resources our members must dedicate to ensuring the safety and vitality of the online marketplace, bears out the truth of the issue highlighted by Peter Navarro, Assistant to the President for Trade and Manufacturing Policy, in his April 3, 2019 Op-Ed piece in The Wall Street Journal - that the sale of counterfeit brand-name goods presents a pervasive and ever-growing threat in the online space. One IACC member reported making*

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<sup>1</sup> OECD (2018), *Governance Frameworks to Counter Illicit Trade*, Illicit Trade, OECD Publishing, Paris, <https://doi.org/10.1787/9789264291652-en>.

<sup>2</sup> Under Federal Register Notice (84 FR 32861), the Department of Commerce sought “comments from intellectual property rights holders, online third-party marketplaces and other third-party intermediaries, and other private-sector stakeholders on the state of counterfeit and pirated goods trafficking through online third-party marketplaces and recommendations for curbing the trafficking in such counterfeit and pirated goods.”

*hundreds of investigative online test purchases over the past year, with a nearly 80% successfully resulting in the receipt of a counterfeit item.<sup>3</sup>*

The scale of counterfeit activity online is evidenced as well by the significant efforts e-commerce platforms themselves have had to undertake. A major e-commerce platform reports that its proactive efforts prevented over 1 million suspected bad actors from publishing a single product for sale through its platform and blocked over 3 billion suspected counterfeit listings from being published to their marketplace. Despite efforts such as these, private sector actions have not been sufficient to prevent the importation and sale of a wide variety and large volume of counterfeit and pirated goods to the American public.

The projected growth of e-commerce fuels mounting fears that the scale of the problem will only increase, especially under a business-as-usual scenario. Consequently, an effective and meaningful response to the President's memorandum is a matter of national import.

#### Actions to be Taken by DHS and the U.S. Government

Despite public and private efforts to-date, the online availability of counterfeit and pirated goods continues to increase. Strong government action is necessary to fundamentally realign incentive structures and thereby encourage the private sector to increase self-policing efforts and focus more innovation and expertise on this vital problem. Therefore, DHS will immediately undertake the following actions and make recommendations for other departments and agencies to combat the trafficking of counterfeit and pirated goods.

<b><i>Immediate Actions by DHS and Recommendations for the U.S. Government</i></b>
<b>1. Ensure Entities with Financial Interests in Imports Bear Responsibility</b>
<b>2. Increase Scrutiny of Section 321 Environment</b>
<b>3. Suspend and Debar Repeat Offenders; Act Against Non-Compliant International Posts</b>
<b>4. Apply Civil Fines, Penalties and Injunctive Actions for Violative Imported Products</b>
<b>5. Leverage Advance Electronic Data for Mail Mode</b>
<b>6. Anti-Counterfeiting Consortium to Identify Online Nefarious Actors (ACTION) Plan</b>
<b>7. Analyze Enforcement Resources</b>
<b>8. Create Modernized E-Commerce Enforcement Framework</b>
<b>9. Assess Contributory Trademark Infringement Liability for Platforms</b>
<b>10. Re-Examine the Legal Framework Surrounding Non-Resident Importers</b>
<b>11. Establish a National Consumer Awareness Campaign</b>

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<sup>3</sup> International Anti-Counterfeiting Coalition's comments made on the Department of Commerce, International Trade Administration, Office of Intellectual Property Rights', Report on the State of Counterfeit and Pirated Goods Trafficking Recommendations, 29 July 2019. Posted on 6 August 2019. <https://www.regulations.gov/document?D=DOC-2019-0003-0072>

## Best Practices for E-Commerce Platforms and Third-Party Marketplaces

Government action alone is not enough to bring about the needed paradigm shift and ultimately stem the tide of counterfeit and pirated goods. All relevant private-sector stakeholders have critical roles to play and must adopt identified best practices, while redoubling efforts to police their own businesses and supply chains.

While the U.S. brick-and-mortar retail store economy has a well-developed regime for licensing, monitoring, and otherwise ensuring the protections of intellectual property rights (IPR), a comparable regime is largely non-existent for international e-commerce sellers. The following table catalogs a set of high priority “best practices” that shall be communicated to all relevant private sector stakeholders by the National Intellectual Property Rights Coordination Center. It shall be the Center’s duty to monitor and report on the adoption of these best practices within the scope of the legal authority of DHS and the Federal government.

<b><i>Best Practices for E-Commerce Platforms and Third-Party Marketplaces</i></b>
<b>1. Comprehensive "Terms of Service" Agreements</b>
<b>2. Significantly Enhanced Vetting of Third-Party Sellers</b>
<b>3. Limitations on High Risk Products</b>
<b>4. Rapid Notice and Takedown Procedures</b>
<b>5. Enhanced Post-Discovery Actions</b>
<b>6. Indemnity Requirements for Foreign Sellers</b>
<b>7. Clear Transactions Through Banks that Comply with U.S. Enforcement Requests for Information (RFI)</b>
<b>8. Pre-Sale Identification of Third-Party Sellers</b>
<b>9. Establish Marketplace Seller ID</b>
<b>10. Clearly Identifiable Country of Origin Disclosures</b>

Foremost among these best practices is the idea that e-commerce platforms, online third-party marketplaces, and other third-party intermediaries such as customs brokers and express consignment carriers must take a more active role in monitoring, detecting, and preventing trafficking in counterfeit and pirated goods.

## 2. Introduction

*E-commerce platforms represent ideal storefronts for counterfeits...and provide powerful platform[s] for counterfeiters and pirates to engage large numbers of potential consumers.*

- Organisation for Economic Cooperation and Development<sup>4</sup>

The rapid growth of e-commerce platforms, further catalyzed by third-party online marketplaces connected to the platforms, has revolutionized the way products are bought and sold. “Online third-party marketplace” means any web-based platform that includes features primarily designed for arranging the sale, purchase, payment, or shipping of goods, or that enables sellers not directly affiliated with an operator of such platforms to sell physical goods to consumers located in the United States.

In the United States, e-commerce year-over-year retail sales grew by 13.3 percent in the second quarter of 2019 while total retail sales increased by only 3.2 percent as brick-and-mortar retail continued its relative decline.<sup>5</sup> For example, Amazon reports third-party sales on its marketplace grew from \$100 million in 1999 to \$160 billion in 2018.<sup>6</sup> In 2018 alone, Walmart experienced an e-commerce sales increase of 40 percent.<sup>7</sup>

Counterfeits threaten national security and public safety directly when introduced into government and critical infrastructure supply chains, and indirectly if used to generate revenue for transnational criminal organizations. Counterfeits also pose risks to human health and safety, erode U.S. economic competitiveness and diminish the reputations and trustworthiness of U.S. products and producers. Across all sectors of the economy, counterfeit goods unfairly compete with legitimate products and reduce the incentives to innovate, both in the United States and abroad.

While the expansion of e-commerce has led to greater trade facilitation, its overall growth—especially the growth of certain related business models—has facilitated online trafficking in counterfeit and pirated goods. American consumers shopping on e-commerce platforms and online third-party marketplaces now face a significant risk of purchasing counterfeit or pirated goods. This risk continues to rise despite current efforts across e-commerce supply chains to reduce such trafficking.

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<sup>4</sup> OECD (2018), *Governance Frameworks to Counter Illicit Trade*, Illicit Trade, OECD Publishing, Paris, <https://doi.org/10.1787/9789264291652-en>.

<sup>5</sup> Department of Commerce, U.S. Census Bureau, Economic Indicators Division, “Quarterly Retail E-Commerce Sales 2<sup>nd</sup> Quarter 2019,” 19 August 2019. <https://www2.census.gov/retail/releases/historical/ecomm/19q2.pdf>

<sup>6</sup> Jeff Bezos, “2018 Letter to Shareholders,” *The Amazon Blog*. 11 April 2019. <https://blog.aboutamazon.com/company-news/2018-letter-to-shareholders>

<sup>7</sup> Note: Walmart does not separate out the percentage of third-party vendor sales. More information can be found, *here*, Jaiswal, Abhishek, “Getting Started Selling on Walmart in 2019: An Insider’s Guide to Success,” *BigCommerce*.

<https://www.bigcommerce.com/blog/selling-on-walmart-marketplace/#millennials-are-the-drivers-of-legacy-brand-change-including-walmart>. See also, “Walmart Marketplace: Frequently Asked Questions,” *Walmart*. <https://marketplace.walmart.com/resources/#1525808821038-8edf332b-5ba2>.

The OECD reports international trade in counterfeit and pirated goods amounted to as much as \$509 billion in 2016. This represents a 3.3 percent increase from 2013 as a proportion of world trade. From 2003<sup>8</sup> through 2018, seizures of infringing goods by the U.S. Customs and Border Protection (CBP) and U.S. Immigration and Customs Enforcement (ICE) increased from 6,500 to 33,810 while the domestic value of seized merchandise — as measured by manufacturer's suggested retail price of the legitimate good (MSRP) — increased from \$94 million in 2003 to \$1.4 billion in 2018.<sup>9</sup>

The rise in consumer use of third-party marketplaces significantly increases the risks and uncertainty for U.S. producers when creating new products. It is no longer enough for a small business to develop a product with significant local consumer demand and then use that revenue to grow the business regionally, nationally, and internationally with the brand protection efforts expanding in step. Instead, with the international scope of e-commerce platforms, once a small business exposes itself to the benefits of placing products online — which creates a geographic scope far greater than its more limited brand protection efforts can handle — it begins to face increased foreign infringement threat.

Moreover, as costs to enter the online market have come down, such market entry is happening earlier and earlier in the product cycle, further enhancing risk. If a new product is a success, counterfeiters will attempt, often immediately, to outcompete the original seller with lower-cost counterfeit and pirated versions while avoiding the initial investment into research and design.

In other words, on these platforms, the counterfeit and pirated goods compete unfairly and fraudulently against the genuine items. While counterfeit and pirated goods have been sold for years on street corners, alleys, and from the trunks of cars, these illicit goods are now marketed to consumers in their homes through increasingly mainstream e-commerce platforms and third party online marketplaces that convey an air of legitimacy.

With the rise of e-commerce, the problem of counterfeit trafficking has intensified. The OECD documents a 154 percent increase in counterfeits traded internationally, from \$200 billion in 2005 to \$509 billion in 2016.<sup>10</sup> Data collected by CBP between 2000 and 2018 shows that seizures of infringing goods at U.S. borders, much of it trafficked through e-commerce, has increased ten-fold. Over 85 percent of the contraband seized by CBP arrived from China and Hong Kong. These high rates of seizures are consistent with a key OECD finding.

*Counterfeit and pirated products come from many economies, with China appearing as the single largest producing market. These illegal products are frequently found in a range of industries, from luxury items (e.g. fashion apparel or deluxe watches), via intermediary products (such as machines, spare parts or*

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<sup>8</sup> [https://www.cbp.gov/sites/default/files/documents/FY2003%20IPR%20Seizure%20Statistics\\_0.pdf](https://www.cbp.gov/sites/default/files/documents/FY2003%20IPR%20Seizure%20Statistics_0.pdf).

<sup>9</sup> [https://www.cbp.gov/sites/default/files/assets/documents/2019-Aug/IPR\\_Annual-Report-FY-2018.pdf](https://www.cbp.gov/sites/default/files/assets/documents/2019-Aug/IPR_Annual-Report-FY-2018.pdf)

<sup>10</sup> OECD/EUIPO (2016), Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact, OECD Publishing, Paris.

<https://www.oecd-ilibrary.org/docserver/9789264252653-en.pdf?Expires=1576509401&id=id&accname=id5723&checksum=576BF246D4E50234EAF5E8EDF7F08147>

*chemicals) to consumer goods that have an impact on personal health and safety (such as pharmaceuticals, food and drink, medical equipment, or toys).<sup>11</sup>*

### Operation Mega Flex

In 2019, in response to the alarmingly high rates of contraband uncovered by DHS and a request from the White House Office of Trade and Manufacturing Policy (OTMP), CBP initiated Operation Mega Flex. This operation uses enhanced inspection and monitoring efforts to identify high-risk violators that are shipping and receiving illicit contraband through international mail facilities and express consignment hubs.

The periodic “blitz operations” conducted under the auspices of Operation Mega Flex examine thousands of parcels from China and Hong Kong and carefully catalog the range of contraband seized. To date, such operations have included visits to seven of CBP’s international mail facilities and four express consignment hubs and the completion of over 20,000 additional inspections. The following table summarizes the findings of three Mega Flex blitzes conducted between July and September of 2019.

<b><i>Results of Operation Mega Flex (2019)</i></b>				
	<b>Blitz I July 16 &amp; 17</b>	<b>Blitz II August 21</b>	<b>Blitz III September 18</b>	<b>Total</b>
<b>Inspections</b>	<b>9,705</b>	<b>5,757</b>	<b>5,399</b>	<b>20,861</b>
<b>Discrepancies</b>	<b>1,145</b>	<b>1,010</b>	<b>735</b>	<b>2,890</b>
<b>Discrepancy Rate</b>	<b>11.8%</b>	<b>17.5%</b>	<b>13.6%</b>	<b>13.9%</b>
<b>Counterfeits</b>	<b>212</b>	<b>467</b>	<b>382</b>	<b>1,061</b>
<b>Counterfeit Rate</b>	<b>2.2%</b>	<b>8.1%</b>	<b>7.1%</b>	<b>5.1%</b>

**Source: U.S. Customs and Border Protection**

Among the discrepancies uncovered by Operation Mega Flex were 1,061 shipments of counterfeit products. These counterfeits range from fake name brand items, like Louis Vuitton bags to sports equipment made with faulty parts. Other contraband included drug paraphernalia, deadly opioids, and counterfeit drivers’ licenses.<sup>12</sup> In all, counterfeits constituted more than one of every three discrepancies uncovered by inspectors.<sup>13</sup>

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<sup>11</sup> OECD/EUIPO (2016), Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact, OECD Publishing, Paris. <https://www.oecd-ilibrary.org/docserver/9789264252653-en.pdf?expires=1576509401&id=id&accname=id5723&checksum=576BF246D4E50234EAF5E8EDF7F08147>

<sup>12</sup> Oren Fliegelman, “Made in China: Fake IDs,” *The New York Times*. 6 February 2015. <https://www.nytimes.com/2015/02/08/education/edlife/fake-ids-or-why-would-a-student-order-a-tea-set.html>

<sup>13</sup> Among the near 3,000 discrepancies, 20% of them were agricultural violations, such as bad meat, fruit, or produce, unsafe for the American consumer. These agricultural discrepancies are dangerous to the United States because they may contain diseases or pests that can greatly impact agriculture. For example, on October 16, 2018, CBP seized nearly 900 pounds of mitten crabs from an incoming Chinese freight. In Asia, mitten crabs are considered a seasonal delicacy; however, they have a disastrous impact on other global habitats and are labeled as an invasive species. See, Department of Homeland Security, U.S. Customs and Border Protection, “CBP Prevents Smuggling of Nearly 900 Pounds of Invasive Mitten Crabs,” 31 October 2018. <https://www.cbp.gov/newsroom/national-media-release/cbp-prevents-smuggling-nearly-900-pounds-invasive-mitten-crabs>.

Authorities also seized 174 controlled or prohibited substances, including: recreational drugs like LSD, cocaine, DMT, ecstasy, marijuana, mushrooms, and poppy pods as well as steroids and highly addictive painkillers like Tramadol.

It is not just a rise in the volume of counterfeits we are witnessing. GAO notes that counterfeiters are increasingly producing a “wider variety of goods that may be sold on websites alongside authentic products.”<sup>14</sup>

DHS finds the current state of e-commerce to be an intolerable and dangerous situation that must be addressed firmly and swiftly by strong actions within the Department and across other relevant agencies of the U.S. Government (USG). These include: The Federal Bureau of Investigation and the Department of Justice, the Department of Commerce, and the Department of the Treasury. This report provides a blueprint for swift and constructive changes and sets forth several actions for immediate implementation.

### 3. Overview of Counterfeit and Pirated Goods Trafficking

While most e-commerce transactions involve legitimate sellers and products, far too many involve the trafficking of counterfeit and pirated goods and expose legitimate businesses and consumers to substantial risks. This is a global phenomenon; the OECD reports international trade in counterfeit and pirated goods amounted to as much as half a trillion dollars in 2016.<sup>15</sup>

#### Key Drivers of Counterfeiting and Piracy in E-Commerce

Historically, many counterfeits were distributed through swap meets and individual sellers located on street corners. Today, counterfeits are being trafficked through vast e-commerce supply chains in concert with marketing, sales, and distribution networks. The ability of e-commerce platforms to aggregate information and reduce transportation and search costs for consumers provides a big advantage over brick-and-mortar retailers. Because of this, sellers on digital platforms have consumer visibility well beyond the seller’s natural geographical sales area.

Selling counterfeit and pirated goods through e-commerce is a highly profitable activity: production costs are low, millions of potential customers are available online, transactions are convenient, and listing on well-branded e-commerce platforms provides an air of legitimacy.

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Other discrepancies found by CBP in the blitz operations included 13 weapon modifications and gun parts, 3 occurrences of drug paraphernalia, and 3 pill presses. For full summary of findings, see, Department of Homeland Security, U.S. Customs and Border Protection, Operation Mega Flex I, II and III Summaries, 2019.

<sup>14</sup>U.S. Government Accountability Office Report to the Chairman, Committee on Finance, U.S. Senate: *Intellectual Property: Agencies Can Improve Efforts to Address Risks Posed by Changing Counterfeits Market*, GAO-18-216, Washington, DC: Government Accountability Office, January 2018. <https://www.gao.gov/assets/690/689713.pdf>

<sup>15</sup>See OECD, Trends in Trade in Counterfeit and Pirated Goods (March 2019), available at <https://www.oecd.org/governance/risk/trends-in-trade-in-counterfeit-and-pirated-goods-g2g9f533-en.htm>

<sup>15</sup>See Parker et al. 2016

When sellers of illicit goods are in another country, they are largely outside the jurisdiction for criminal prosecution or civil liability from U.S. law enforcement and private parties.

#### *The Role of Online Third-Party Marketplaces*

Third-party online marketplaces can quickly and easily establish attractive “store-fronts” to compete with legitimate businesses. On some platforms, little identifying information is necessary to begin selling.

A counterfeiter seeking to distribute fake products will typically set up one or more accounts on online third-party marketplaces. The ability to rapidly proliferate third-party online marketplaces greatly complicates enforcement efforts, especially for intellectual property rights holders. Rapid proliferation also allows counterfeiters to hop from one profile to the next even if the original site is taken down or blocked. On these sites, online counterfeiters can misrepresent products by posting pictures of authentic goods while simultaneously selling and shipping counterfeit versions.

Counterfeiters have taken full advantage of the aura of authenticity and trust that online platforms provide. While e-commerce has supported the launch of thousands of legitimate businesses, their models have also enabled counterfeiters to easily establish attractive “store-fronts” to compete with legitimate businesses.

Platforms use their third-party marketplace functions to leverage “two-sided” network effects to increase profitability for the platform by adding both more sellers and more buyers. Because sellers benefit with each additional buyer using the platform (more consumers to sell to), and buyers are more likely to join/use the platform with each additional seller (more sellers to buy from), there can be diminished internal resistance to adding lower quality sellers.

Platforms that recognize this strategy may incentivize seller listings to stimulate further growth and increase profits but do so without adequate scrutiny. As just one incentive, many platforms create “frictionless entry” by reducing the costs for sellers and buyers to join, thereby increasing the likelihood that the platform will reach an efficient and highly profitable scale.

Platforms also generate value by opening previously unused (or less frequently used) markets. In addition, online platforms reduce transaction costs by streamlining the actual transaction; for example, buyers and sellers use a standardized transaction method that simplifies interactions with buyers and reduces the risk that the buyer will not pay.

For example, before the rise of e-commerce, secondhand products could be sold at garage sales or in classified newspaper advertisements. E-commerce created a process for allowing buyers and sellers to trade goods digitally, reducing transaction costs and creating a global marketplace for used, but too often counterfeit, products.

Another way platforms generate value is by aggregating information and reducing search costs. A buyer may search for a product, either by keyword or product category, at lower search cost than visiting brick-and-mortar stores. Because of this, sellers on digital platforms have consumer visibility well beyond the seller’s natural geographical sales area.

In addition, consumers who have made a purchase may use tools provided by the marketplace to rate the product and the seller involved. These ratings create an important mechanism to facilitate future consumer trust in an otherwise unknown seller.

In principle, such a rating system provides a key to overcoming a common economic problem that might otherwise preclude sales: without a low-cost trust building feature that also communicates quality, and in a market with significant numbers of low-quality products, buyers may refuse to purchase any product at all, or would demand a lower price to reflect the uncertainty. One frequent result is that low cost counterfeits drive out high quality, trusted brands from the online marketplace. In practice, even the ratings systems across platforms have been gamed, and the proliferation of fake reviews and counterfeit goods on third-party marketplaces now threatens the trust mechanism itself.

#### *Lower Startup and Production Costs*

The relative ease of setting up and maintaining e-commerce websites makes online marketplaces a prime locale for the retailing of counterfeit and pirated goods. E-commerce retailers enjoy low fixed costs of setting up and maintaining web businesses and lower costs for carrying out normal business operations such as managing merchant accounts. These ventures can be set up quickly without much sophistication or specialized skills.

Some online platforms allow retailers to use pre-made templates to create their stores while other platforms only require that a seller create an account. These businesses face much lower overhead costs than traditional brick-and-mortar sellers because there is no need to rent retail space or to hire in-person customer-facing staff. Not only can counterfeiters set up their virtual storefronts quickly and easily, but they can also set up new virtual storefronts when their existing storefronts are shut down by either law enforcement or through voluntary initiatives set up by other stakeholders such as market platforms, advertisers, or payment processors.

In the production stage, counterfeiters keep costs low by stealing product secrets or technological knowledge, exploiting new production technologies, and distributing operations across jurisdictions. One method involves employees who sell trade secrets to a third party who, in turn, develops and sells counterfeit products based on the stolen secrets. Another method relies on an intermediary to steal a firm's product or technology. The use of intermediaries reduces the traceability to the counterfeiter.

Counterfeiting and piracy operations also take advantage of new low-cost production technologies. For example, the technological advances in modeling, printing and scanning technologies such as 3D printing reduce the barriers for reverse engineering and the costs of manufacturing counterfeit products.

Lower production costs can also be achieved through distributed production operations. One method involves manufacturing the counterfeit good in a foreign market to lower the chances of detection and to minimize legal liability if prosecuted. This can be combined with importation of

the counterfeit labels separately from the items, with the labels being applied to the products after both items arrive in the U.S.

In addition, it is much cheaper to manufacture illicit goods because counterfeit and pirated goods are often produced in unsafe workplaces with substandard and unsafe materials by workers who are often paid little—and sometimes nothing in the case of forced labor. Moreover, in the case of goods governed by Federal health and safety regulations, it often costs much less to produce counterfeit versions that do not meet these health and safety standards.

#### *Lower Marketing Costs*

Businesses that use only an internet presence as their consumer-facing aspect typically enjoy lower costs of designing, editing, and distributing marketing materials. Counterfeitors also benefit from greater anonymity on digital platforms and web sites and greater ease to retarget or remarket to customers. For example, counterfeiters use legitimate images and descriptions on online platforms to confuse customers, and they open multiple seller accounts on the platform so that if one account is identified and removed, the counterfeiter can simply use another.

The popularity of social media also helps reduce the costs of advertising counterfeit products. The nature of social media platforms has aided in the proliferation of counterfeits across all e-commerce sites. Instagram users, for example, can take advantage of connectivity algorithms by using the names of luxury brands in hashtags. Followers can search by hashtag and unwittingly find counterfeit products, which are comingled and difficult to differentiate from legitimate products and sellers.

#### *Lower Distribution Costs*

Traditionally, many counterfeit goods were distributed through swap meets and individual sellers located on street corners. With the rise of online platforms for shopping, customers can have products delivered to them directly.

Foreign entities that traffic in counterfeits understand how to leverage newer distribution methods better suited to e-commerce than the traditional trade paradigm (i.e., imports arriving via large cargo containers with domestic distribution networks). Today, mail parcel shipments, including through express consignments, account for more than 500 million packages each year.<sup>16</sup> Seizures in the small package environment made up 93 percent of all seizures in 2018, a 6 percent increase over 2017. From 2012 to 2016, the number of seizures from express consignment carriers increased by 105 percent, and the MSRP of those seizures had a 337 percent increase.<sup>17</sup> In contrast, seizures from cargo decreased by 36 percent from FY17 to FY18.

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<sup>16</sup><https://www.cbp.gov/sites/default/files/assets/documents/2019-Apr/FY%202017%20Seizure%20Stats%20Booklet%20-%20508%20Compliant.pdf> p. 14

<sup>17</sup>[https://www.gao.gov/assets/690/689713.pdf?mod=article\\_inline](https://www.gao.gov/assets/690/689713.pdf?mod=article_inline) p. 14

The International Chamber of Commerce found that counterfeiters use international air packages because the high volume of these packages makes enforcement more difficult.<sup>18</sup> A recent report by the OECD points out that distributing counterfeits across a series of small packages spreads the risk of detection, and lowers the loss from having one or more shipments seized, suggesting that losses to the counterfeiter on an ongoing basis would be within a tolerable range.<sup>19</sup>

The OECD report also notes that it is harder for authorities to detect counterfeits in small parcels than in shipping containers because cargo containers making entry at a maritime port provide customs officials with more information, well in advance of arrival. Moreover, the effort required for CBP to seize a shipment does not vary by size of the shipment, meaning that a package of a few infringing goods requires the same resources to seize as a cargo container with hundreds of infringing goods.

Section 321 of the Tariff Act of 1930 has likewise encouraged counterfeiters to favor smaller parcel delivery. Under Section 321, a foreign good valued at or less than \$800 and imported by one person on one day is not subject to the same formal customs entry procedures and rigorous data requirements as higher-value packages entering the United States. This reduced level of scrutiny is an open invitation to exploit Section 321 rules to transport and distribute counterfeits.

Rules set by the Universal Postal Union (UPU) have historically contributed to the distortion in rates for delivery of international e-commerce purchases to the United States.<sup>20</sup> UPU reimbursement rates have underpriced domestic postage rates for small parcels. This market distortion made it cheaper for small package exports to the United States from certain countries than would otherwise be economically feasible and has encouraged the use of the international postal mode over other shipment channels. The United States recently scored a historic victory when the UPU overhauled its terminal dues system<sup>21</sup>, effectively eliminating this outdated policy.<sup>22</sup>

### *Consumer Attitudes and Perceptions*

The sale of counterfeits away from so-called “underground” or secondary markets (e.g. street corners, flea markets) to e-commerce platforms is reshaping consumer attitudes and perceptions. Where in the past, consumers could identify products by relying on “red flag” indicators—such as a suspicious location of the seller, poor quality packaging, or discount pricing—consumers are now regularly exposed to counterfeit products in settings and under conditions where the articles appear genuine.

While the risks of receiving a counterfeit may have been obvious to a consumer purchasing items on street corners, with the rise of online platforms, it is not so obvious anymore. For example, it is

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<sup>18</sup><https://cdn.iccwbo.org/content/uploads/sites/3/2015/03/ICC-BASCAP-Roles-and-Responsibilities-of-Intermediaries.pdf> p. 32

<sup>19</sup>OECD/EUIPO (2018), *Misuse of Small Parcels for Trade in Counterfeit Goods: Facts and Trends, Illicit Trade*, OECD Publishing, Paris. <https://doi.org/10.1787/9789264307858-en> p. 77

<sup>20</sup>The UPU is a specialized agency of the United Nations that coordinates postal policies between 190 countries. Importantly, these treaties determine the cost of shipping between the various countries and offers low rates to mail originating from abroad, as compared to domestic postage rates.

<sup>21</sup> Universal Postal Union (2019), *Decisions of the 2019 Geneva Extraordinary Congress*, [http://www.upu.int/uploads/tx\\_sbdownloader/actsActsOfTheExtraordinaryCongressGenevaEn.pdf](http://www.upu.int/uploads/tx_sbdownloader/actsActsOfTheExtraordinaryCongressGenevaEn.pdf)

<sup>22</sup> <https://www.nytimes.com/2019/09/25/business/universal-postal-union-withdraw.html>

unlikely that anyone would set out to purchase a counterfeit bicycle helmet given the potential safety risks; however, such items are readily available to unsuspecting consumers on e-commerce websites.

Reports indicate that some third-party marketplace listings falsely claim to have certifications with health and safety standards or offer items banned by federal regulators or even the platforms themselves. Coupled with the inability of buyers to accurately determine the manufacturer or the origin of the product, it is challenging for buyers to make informed decisions in the e-commerce environment.

In 2017, MarkMonitor found that 39 percent of all unwitting purchases of counterfeit goods were bought through online third-party marketplaces.<sup>23</sup> Sellers on large well-known platforms rely on the trust that those platforms hosting of the marketplace elicits. The results of this survey indicate that bad actors selling counterfeit goods on legitimate online platforms erodes trust in both the brands and the platforms themselves.

In 2018, Incopro conducted a survey focusing on United Kingdom (UK) consumers who had unwittingly purchased counterfeit goods and how their perceptions of online marketplaces were affected as a result.<sup>24</sup> The results of this survey show that 26 percent of respondents reported that they had unwittingly purchased counterfeits. Of these, 41 percent reported that they had never received a refund after reporting a seller to online marketplaces.

In addition, roughly one-third of respondents reported that they would be less likely to buy a widely counterfeited product from an online marketplace while 46 percent reported no longer using a particular online marketplace after receiving counterfeit goods. Respondents also reported that, when trying to differentiate between genuine and counterfeit products, they consider online reviews along with the reputation of online marketplaces.

These recent findings, against the larger backdrop of the e-commerce environment, demonstrate the immediacy of the problem as consumer confidence and brand integrity continue to suffer in the realm of online third-party marketplaces.

### Top Products Prone to Counterfeiting and Piracy

Counterfeitors sell fake goods as authentic goods — for example, a copy of a Louis Vuitton bag or Rolex watch fraudulently sold as the “real thing.” Counterfeitors use identical copies of registered trademarks without the authorization of the rightful owner.

Piracy typically refers to the act of copying a protected work (such as a book, movie, or music) without the consent of the rights holder or person duly authorized by the rights holder.

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<sup>23</sup>MarkMonitor (2017). *MarkMonitor Online Barometer: Global online shopping survey 2017 – consumer goods*. Downloaded from [https://www.markmonitor.com/download/report/MarkMonitor\\_Online\\_Shopping\\_Report-2017-UK.pdf](https://www.markmonitor.com/download/report/MarkMonitor_Online_Shopping_Report-2017-UK.pdf). p. 6

<sup>24</sup>INCOPRO, 2018. Counterfeit Products are Endemic – and it is damaging brand value: INCOPRO Market Research Report available at [https://www.incoproip.com/cms/wp-content/uploads/2018/11/2018\\_Incopro\\_Market-Research-report.pdf](https://www.incoproip.com/cms/wp-content/uploads/2018/11/2018_Incopro_Market-Research-report.pdf).

were between 2 million and 2.6 million jobs in 2013, with job displacement expected to double by 2022.

Counterfeit goods also damage the value of legitimate brands. When brand owners lose the ability to collect a price premium for branded goods, it leads to diminished innovation as brand owners are less likely to invest in creating innovative products. Legitimate companies, and particularly small businesses, report devastating impacts due to the abundance of competing online counterfeits and pirated goods. Moreover, while e-commerce platforms can benefit legitimate businesses by helping them to reach customers with a new product, the same process and technology also makes it easier for unscrupulous firms to identify popular new products, produce infringing versions of them, and sell these illicit goods to the business's potential customers.

As previously noted, the speed at which counterfeiters can steal intellectual property through e-commerce can be very rapid. If a new product is a success, counterfeiters may attempt to immediately outcompete the original seller with lower-cost counterfeit versions — while avoiding research and development costs. The result: counterfeiters may have a significant competitive advantage in a very short period of time over those who sell trusted brands.

Such fast-track counterfeiting poses unique and serious problems for small businesses, which do not have the same financial resources as major brands to protect their intellectual property. Lacking the ability to invest in brand-protection activities, such as continually monitoring e-commerce platforms to identify illicit goods, perform test buys, and send takedown notices to the platforms, smaller businesses are more likely to experience revenue losses as customers purchase counterfeit versions of the branded products.

In many cases, American enterprises have little recourse aside from initiating legal action against a particular vendor. Such legal action can be extremely difficult. Many e-commerce sellers of infringing products are located outside the jurisdiction of the United States, often in China; existing laws and regulations largely shield foreign counterfeiters from any accountability.

## **Organized Crime and Terrorism**

The impact of counterfeit and pirated goods is broader than just unfair competition. Law enforcement officials have uncovered intricate links between the sale of counterfeit goods and transnational organized crime. A study by the Better Business Bureau notes that the financial operations supporting counterfeit goods typically require central coordination, making these activities attractive for organized crime, with groups such as the Mafia and the Japanese Yakuza heavily involved.<sup>33</sup> Criminal organizations use coerced and child labor to manufacture and sell counterfeit goods. In some cases, the proceeds from counterfeit sales may be supporting terrorism and dictatorships throughout the world.<sup>34</sup>

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<sup>33</sup>[https://www.bbb.org/globalassets/local-bbbs/st-louis-mo-142/st\\_louis\\_mo\\_142/studies/counterfeit-goods/BBB-Study-of-Counterfeit-Goods-Sold-Online.pdf](https://www.bbb.org/globalassets/local-bbbs/st-louis-mo-142/st_louis_mo_142/studies/counterfeit-goods/BBB-Study-of-Counterfeit-Goods-Sold-Online.pdf)

<sup>34</sup>United Nations Office of Drugs and Crime (UNODC), *Focus On: The Illicit Trafficking of Counterfeit Goods and Transnational Organized Crime*, available at: [https://www.unodc.org/documents/counterfeit/FocusSheet/Counterfeit\\_focussheet\\_EN\\_HIRES.pdf](https://www.unodc.org/documents/counterfeit/FocusSheet/Counterfeit_focussheet_EN_HIRES.pdf)

## National Security

One of the greatest threats counterfeits pose to national security is their entry into the supply chain of America's defense industrial base. This defense industrial base includes both private sector contractors and government agencies, particularly the Department of Defense.

In FY 2018, 12 percent of DHS seizures included counterfeit versions of critical technological components, automotive and aerospace parts, batteries, and machinery. Each of these industrial sectors have been identified as critical to the defense industrial base, and thus critical to national security. One example drawn from a 2018 study by the Bureau of Industry and Security within the Department of Commerce featured the import of counterfeit semiconductors or "Trojan chips" for use in defense manufacturing and operations<sup>35</sup>. Such Trojan chips can carry viruses or malware that infiltrate and weaken American national security. The problem of counterfeit chips has become so pervasive that the Department of Defense has referred to it as an "invasion." Companies from China are the primary producers of counterfeit electronics.<sup>36</sup>

## 5. How E-Commerce Facilitates Counterfeit Trafficking

While e-commerce has supported the launch of thousands of legitimate businesses, e-commerce platforms, third-party marketplaces, and their supporting intermediaries have also served as powerful stimulants for the trafficking of counterfeit and pirated goods. The central economic driver of such trafficking is this basic reality: Selling counterfeit and pirated goods through e-commerce platforms and related online third-party marketplaces is a highly profitable venture.

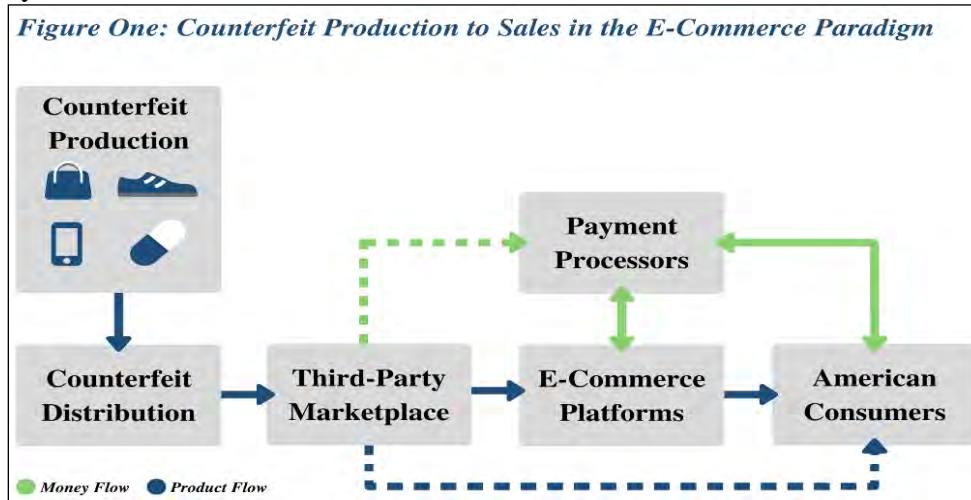
For counterfeiters, production costs are low, millions of potential customers are available online, transactions are convenient, and listing goods on well-known platforms provides an air of legitimacy. When sellers of illicit goods are in another country, they are also exposed to relatively little risk of criminal prosecution or civil liability under current law enforcement and regulatory practices. It is critical that immediate action be taken to protect American consumers and other stakeholders against the harm and losses inflicted by counterfeiters.

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<sup>35</sup><https://www.bis.doc.gov/index.php/documents/technology-evaluation/37-defense-industrial-base-assessment-of-counterfeit-electronics-2010/file>

<sup>36</sup>Saunders, Gregory and Tim Koczanski, "Counterfeits," *Defense Standardization Program Journal*, October/December 2013. <https://www.dsp.dla.mil/Portals/26/Documents/Publications/Journal/131001-DSPJ.pdf>

Figure One provides a simplified overview of how counterfeit products move from production by counterfeiters to sales to American consumers:



### Counterfeit Production and Distribution

The counterfeit sales process begins with some type of production capability for the counterfeit good. In this stage, counterfeiters enjoy enormous production cost advantages relative to legitimate businesses. Counterfeits are often produced in unsafe workplaces, with substandard and unsafe materials, by workers who are often paid little or sometimes nothing in the case of forced labor.

In the case of goods subject to federal health and safety regulations, it costs much less to produce counterfeit versions that do not meet these health and safety requirements that make the legitimate products so safe.

Counterfeitors likewise minimize the need for incurring significant research and development expenditures by stealing intellectual property, technologies, and trade secrets. They also shave production costs using inferior ingredients or components.

For example, a common way for counterfeiters to produce *fake* prescription opioids like Oxycontin, or a prescription drug like Viagra, is to start with the *real* pills as a basic ingredient. These real pills are then ground up into a powder, diluted with some type of (sometimes toxic) powder filler, and then “spiked” with an illegal and deadly narcotic like fentanyl, in the case of fake opioids, or illegal and deadly amphetamines or strychnine, in the case of Viagra.

In the case of apparel, such as running shoes, employees from a legitimate branded company may leave the company and set up their own facility. These employees have the expertise to manufacture identical-looking shoes; but they will typically do so with cheaper, inferior components. The result: the shoes may fail during activity, injure the user with an inferior insole, or, at a minimum, wear out faster than the real product.<sup>37</sup>

<sup>37</sup>Department of Homeland Security, U.S. Customs and Border Protection, “CBP Seizes Over \$2.2 Million worth of Fake Nike Shoes at LA/Long Beach Seaport,” 9 October 2019. <https://www.cbp.gov/newsroom/local-media-release/cbp-seizes-over-22-million-worth-fake-nike-shoes-lalong-beach-seaport>

The technological advances in modeling, printing, and scanning technologies such as 3D printing, have also significantly reduced the barriers for reverse engineering and the costs of manufacturing counterfeit products. Again, one problem that may arise may be the use of inferior production inputs that lead to product failure.

These are just a few of the many ways counterfeits begin their long journey into American households. There is often no way for legitimate businesses to compete, on a production cost basis, with counterfeiters. There is also often no way for a consumer to tell the difference between a counterfeit and legitimate good.

### Third-Party Marketplaces and Counterfeiter Websites

A counterfeiter seeking to distribute fake products will typically set up one or more accounts on third-party marketplaces, and these accounts can often be set up quickly and without much sophistication or many specialized skills. Under such circumstances, it is axiomatic that online retailers face much lower overhead costs than traditional brick-and-mortar sellers. There is no need to rent retail space or to hire in-person, customer-facing staff.

In a common scenario, third-party marketplace websites contain photos of the real product, fake reviews of the counterfeit product, and other such disinformation designed to mislead or fool the consumer into believing the legitimacy of the product. The proliferation of such disinformation is the hallmark of the successful online counterfeiter. Such deception not only provides counterfeiters with an enormous competitive advantage over their brick-and-mortar counterparts; legitimate sellers on the internet are harmed as well.

In some cases, counterfeiters hedge against the risk of being caught and their websites taken down from an e-commerce platform by preemptively establishing multiple virtual store-fronts. A key underlying problem here is that on at least some e-commerce platforms, little identifying information is necessary for a counterfeiter to begin selling. In the absence of full transparency, counterfeiters can quickly and easily move to a new virtual store if their original third-party marketplace is taken down.

The popularity of social media also helps proliferate counterfeits across various e-commerce platforms. Instagram users, for example, can take advantage of connectivity algorithms by using the names of luxury brands in hashtags. Followers can search by hashtag and unwittingly find counterfeit products, which are comingled and difficult to differentiate from legitimate products and sellers.

According to a 2019 report, *Instagram and Counterfeiting*, nearly 20 percent of the posts analyzed about fashion products on Instagram featured counterfeit or illicit products.<sup>38</sup> More than 50,000 Instagram accounts were identified as promoting and selling counterfeits, a 171 percent increase from a prior 2016 analysis. Instagram's Story feature, where content disappears in twenty-four hours, was singled out as particularly effective for counterfeit sellers.

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<sup>38</sup>Stroppa, Andrea, *et al.*, "Instagram and counterfeiting in 2019: new features, old problems," *Ghost Data*, 9 April 2019. Rome, New York. [https://ghostdata.io/report/Instagram\\_Counterfeiting\\_GD.pdf](https://ghostdata.io/report/Instagram_Counterfeiting_GD.pdf)

A more recent development on social media is the proliferation of “hidden listings” for the sale of counterfeits. Social media is used to provide direct hyperlinks in private groups or chats to listings for counterfeit goods that purport to be selling unrelated legitimate items. By accessing the link, buyers are brought to an e-commerce platform which advertises an unrelated legitimate item for the same price as the counterfeit item identified in the private group or chat. The buyer is directed to purchase the unrelated item in the listing but will receive the sought-after counterfeit item instead.

### Order Fulfillment in E-Commerce

The foreign counterfeiter must first choose between sending a package either by express consignment carrier or through the international post. As a general proposition, express consignment shippers — such as DHL Express, Federal Express, and the United Parcel Service — were subject to data requirements before they were extended to the international posts.

In the next step along the delivery chain, a parcel will arrive at a port of entry under the authority of CBP. Millions of parcels arrive daily, and it is impossible to inspect more than a very small fraction.

Although ocean shipping is still a major mode of transport for counterfeits, the rapid growth of other modes, such as truck and air parcel delivery, threaten to upend established enforcement efforts, and as such, is increasingly used by international counterfeiters. This continued shift from bulk cargo delivery to other modes by counterfeiters is illustrated in the trends in seizure statistics.

It is clear from these observations that counterfeit traffickers have learned how to leverage newer air parcel distribution methods that vary from the traditional brick-and-mortar retail model (for example, imports arriving via large cargo containers with domestic distribution networks). This is an issue that must be directly addressed by firm actions from CBP.

### Section 321 De Minimis Exemption and Counterfeit Trafficking

Under Section 321 of the Tariff Act of 1930, as amended by the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA), articles with a value of \$800 or less, imported by one person on one day, can be admitted free of duty and taxes. Under 19 CFR § 10.151 and 19 CFR part 143, Subpart C, those importations are often not subject to the same formal customs procedures and rigorous data requirements as higher-value packages entering the United States. Instead, the low-value shipments can be admitted into U.S. commerce with the presentation of a bill of lading or a manifest listing each bill of lading and a limited data set. The relatively limited nature of the data requirements complicates the identification of high-risk goods by CBP and other enforcement agencies. Under 19 CFR § 143.22, CBP has existing authority to require formal entry (and the complete data set for any shipment) for any merchandise, if deemed necessary for import admissibility enforcement purposes; revenue protection; or the efficient conduct of customs business.

## 9. Assess Contributory Trademark Infringement Liability for E-Commerce

Online platforms have avoided civil liability for contributory trademark infringement in several cases. Given the advance and expansion of e-commerce, DHS recommends that the Department of Commerce consider the following measures:

- Assess the state of liability for trademark infringement considering recent judicial opinions, and the impact of this report—including platforms’ implementation of the best practices directed herein.
- Seek input from the private sector and other stakeholders as to the application of the traditional doctrines of trademark infringement to the e-commerce setting, including whether to pursue changes in the application of the contributory and/or vicarious infringement standards to platforms.

## 10. Re-Examine the Legal Framework Surrounding Non-Resident Importers

Currently, non-resident importers can legally enter goods into the United States provided they have a “resident agent” as defined in regulation. In practice, it can be difficult to compel non-resident importers to pay civil penalties and respond to other enforcement actions available to the USG. With this in mind, DHS should reevaluate the legal framework for allowing non-resident importers in the Section 321 *de minimis* low-value shipment environment.

## 11. Establish a National Consumer Awareness Campaign

Given the critical role that consumers can play in the battle against online counterfeiting, DHS recommends the development of a national public-private awareness campaign. The national public awareness campaign recommended by DHS should involve platforms, rights holders, and the applicable government agencies to provide education for consumers regarding the risks of counterfeits as well as the various ways consumers can use to spot counterfeit products. At present, many consumers remain uninformed as to the risks of buying counterfeit and pirated products online. These risks are both direct to them (e.g., tainted baby food), as well as indirect (e.g., sales revenues can fund terrorism).

Many consumers are also unaware of the significant probabilities they face of being defrauded by counterfeiters when they shop on e-commerce platforms. As this report has documented, these probabilities are unacceptably high and appear to be rising. Even those consumers motivated to conduct research and stay informed might lack the specialized knowledge and efficient user tools to make diligent online buying decisions.

A strong and ongoing national campaign to increase public awareness about the risks of counterfeits in an e-commerce world should help alert consumers about the potential dangers of some online purchases. To the extent e-commerce platforms empower their consumers to participate in the monitoring and detection of counterfeits, e.g., by implementing several of the best practices recommended in this report, this will also help in the fight against the trafficking in counterfeit and pirated goods.

This effort could use technology as well as provide online education. For example, online marketplaces could prominently display messages on their home pages, as well as on high-risk item pages, warning customers about the dangers of counterfeits and urging respect for intellectual property rights. Additionally, the campaign could be paired with technologically-enabled assurances of authenticity. Such an approach would provide commercial advantages to the platforms that adopt it while also benefiting consumers and rights holders through reliable methods to identify and certify the authenticity of branded products across online platforms.

## 8. Private Sector Best Practices

The following table catalogs a set of high priority “best practices” that should be swiftly adopted by e-commerce platforms that operate third-party marketplaces, and other third-party intermediaries. Under the authority of the Secretary of the Department of Homeland Security, these best practices shall be recommended and communicated to all relevant private sector stakeholders by the ICE/HSI-led IPR Center.

It shall be a duty of the IPR Center to encourage, monitor, and report on the adoption of, and the progress and effectiveness of, these best practices, through all means necessary within the scope of the legal authority of DHS and the Federal Government.

<b><i>Best Practices for E-Commerce Platforms and Third-Party Marketplaces</i></b>
1. Comprehensive "Terms of Service" Agreements
2. Significantly Enhanced Vetting of Third-Party Sellers
3. Limitations on High Risk Products
4. Efficient Notice and Takedown Procedures
5. Enhanced Post-Discovery Actions
6. Indemnity Requirements for Foreign Sellers
7. Clear Transactions Through Banks that Comply with U.S. Enforcement Requests
8. Pre-Sale Identification of Third-Party Sellers
9. Establish Marketplace Seller IDs
10. Clearly Identifiable Country of Origin Disclosures

### 1. Comprehensive “Terms of Service” Agreements

It is critical that platforms require all third-party sellers to sign comprehensive and stringent terms of service agreements that maximize the authorities of the platforms to combat counterfeit

trafficking. Terms of service agreements will provide platforms with an important legal means to combat counterfeit trafficking

Most obviously, these terms of service should incorporate explicit prohibitions on selling counterfeit and pirated goods. Once the platform has affirmatively detected infringement on a seller profile, the actions listed below under the category of “post-discovery actions” should be allowed under the terms and taken swiftly.

The terms of service should also list the potential repercussions sellers face for violations. Generally, these repercussions should allow platforms to impose sanctions such as suspension, termination, and debarment without waiting for a determination by a court for sellers who violate the terms of the agreement. The terms should include escalating capabilities to suspend, terminate, and debar counterfeit traffickers and their affiliates.

Specifically, they should allow the platform to conduct, at a minimum, the following actions in response to violations or identified risk factors in the seller’s profile and product postings without waiting for a determination by a court:

- (1) terminate or suspend a seller account based on the use or reference to a username that is confusingly similar to a registered trademark;
- (2) take down or suspend and keep down individual product postings based on the misuse of photographs, logos, external links to infringing content, certain coded messages with actual intellectual property references removed, or imbedded offers to manufacture; and
- (3) allow for an escalating enforcement structure that results in (for major infractions and/or repeat minor infractions) permanent removal of the seller, and any known related seller profiles, from the marketplace feature of the platform and further results in forfeiture and destruction of all offending goods in warehouses or fulfillment centers operated by, or under the control of, the platform.

To maximize platform authorities, and as explained further below, such terms of service should also allow platforms to impose appropriate limitations on products listed, require clearly identifiable country of origin disclosures, impose U.S. banking and indemnity requirements, and significantly improve pre-sale identification of third-party sellers.

## 2. Significantly Enhanced Vetting of Third-Party Sellers

Significantly enhanced vetting of third-party sellers is one of the most effective forms of due diligence platforms can engage in to reduce the risk of counterfeits entering the e-commerce stream. Platforms should have a uniform and articulable vetting regime to determine if a seller will be allowed to list products for sale.

To facilitate enhanced vetting, platforms should, at a minimum, require the following:

- (1) sufficient identification of the seller, its accounts and listings, and its business locations prior to allowing the seller to list products on the platform;
- (2) certification from the seller as to whether it, or related persons, have been banned or removed from any major e-commerce platforms, or otherwise implicated in selling counterfeit or pirated products online; and
- (3) acknowledgment, where applicable, that the seller is offering trademarked products for which the seller does not own the rights (either because they are a reseller or seller of used products).

Information provided by potential sellers should also be vetted for accuracy, including through the following efforts:

- (1) use of technological tools, as well as analyses of historical and public data, to assess risk of sellers and products; and
- (2) establishment of an audit program for sellers, concentrating on repeat offenders and those sellers exhibiting higher risk characteristics.

Any failure to provide accurate and responsive information should result in a determination to decline the seller account and/or to hold the seller in violation of the platform's terms of service.

### 3. Limitations on High Risk Products

Platforms should have in place protocols and procedures to place limitations on the sale of products that have a higher risk of being counterfeited or pirated and/or pose a higher risk to the public health and safety. For example, some of the major platforms completely prohibit the sale of prescription medications by third-party sellers in their marketplaces. Many platforms also ban the sale of products that are known to be particularly vulnerable to counterfeiting and that pose a safety risk when sold online. Examples include car airbag components, infant formula, and new batteries for cellular phones.

Platforms can also place other types of restrictions on third-party sellers before certain high-risk categories of goods may be sold. For example, some platforms require prior approval for items such as automotive parts, jewelry, art, food, computers, sports collectibles, DVDs, and watches that are particularly prone to counterfeiting.

Platforms should prominently publish a list of items that may not be sold on third-party marketplaces under any circumstances (prohibited), as well as a list of items that can only be sold when accompanied by independent third-party certification (restricted). In constructing these lists, platforms should consider, among other things, whether a counterfeit version of the underlying product presents increased risks to the health and safety of U.S. residents or the national security of the United States. When a seller claims their merchandise has an independent third-party certification, and this certification is required in order for the product to be legally offered for sale

in the United States, platforms should make good-faith efforts to verify the authenticity of these certifications.

#### 4. Efficient Notice and Takedown Procedures

Notice and takedown is the most common method of removing counterfeit listings from third-party marketplaces and e-commerce platforms. This noticing process can be particularly time-consuming and resource-intensive for rights holders who currently bear a highly disproportionate share of the burden of identifying the counterfeit listings for noticing.

These rights holders must invest significant resources to scour millions of listings across multiple platforms to identify potentially counterfeit listings and notify the third-party marketplace or e-commerce platform. This kind of comprehensive policing of e-commerce often is not possible for smaller enterprises.

As a further burden, some third-party marketplaces require rights holders to buy the suspected products from the sellers to verify that they are in fact counterfeit. There often is a delay of a day or longer between the time that notice is provided, and the time listing is removed. During this period, counterfeiters may continue to defraud American consumers.

To address these abuses — and assume a much greater share of responsibility for the policing of e-commerce — platforms should create and maintain clear, precise, and objective criteria that allow for quick and efficient notice and takedowns of infringing seller profiles and product listings. An effective regime should include, at a minimum, the following: (1) minimal registration requirements for an interested party to participate in the notice and takedown process; (2) reasonable rules that treat profile owners offering large quantities of goods on consumer-to-consumer platforms as businesses; and (3) transparency to the rights holders as to how complaints are resolved along with relevant information on other sales activity by the seller that has been implicated.

#### 5. Enhanced Post-Discovery Actions

Upon discovery that counterfeit or pirated goods have been sold, platforms should conduct a series of “post-discovery” actions to remediate the fraud. These should include:

- (1) notification to any buyer(s) likely to have purchased the goods in question with the offer of a full refund;
- (2) notification to implicated rights holders, with details of the infringing goods, and information as to any remaining stock of the counterfeit and pirated goods held in warehouses;
- (3) implementation of practices that result in the removal of counterfeit and pirated goods within the platform’s effective control and in a manner that prevents such goods from re-entering the U.S. or being diverted to other markets; and

(4) immediate engagement with law enforcement to provide intelligence and to determine further courses of action.

## 6. Indemnification Requirements for Foreign Sellers

For a large portion of e-commerce, foreign sellers do not provide security or protection against a loss or other financial burden associated with the products they sell in the United States. Because these sellers are located outside the United States, they also may not be subject to the jurisdiction of U.S. courts in civil litigation or government enforcement actions. Further adding to this liability gap, there is this: while e-commerce platforms generally have a U.S. presence and are under U.S. jurisdiction, under the current interpretations of American laws and regulations, they are often found not to be liable for harm caused by the products they sell or distribute.

The result of this jurisdictional and liability gap is that consumers and rights holders do not have an efficient or predictable form of legal recourse when they are harmed by foreign products sold on third-party marketplaces. Accordingly, e-commerce platforms should require foreign sellers to provide some form of security in cases where a foreign product is sold to a U.S. consumer. Such form of security should be specifically designed to cover the potential types and scope of harm to consumers and rights holders from counterfeit or pirated products.

Note that there are several ways that platforms might flexibly achieve this goal. For example, requiring proof of insurance would provide a form of security for any reasonably foreseeable damages to consumers that might flow from the use of the product. Rights holders could also be compensated in cases of infringement.

## 7. Clear Transactions Through Banks that Comply with U.S. Enforcement Requests

Many foreign sellers on third-party marketplaces do not have a financial nexus to the United States, making it difficult to obtain financial information and to subject all parts of the transaction to U.S. law enforcement efforts.

Platforms should close this loophole by encouraging all sellers to clear transactions only with banks and payment providers that comply with U.S. law enforcement requests for information and laws related to (relevant to) the financing of counterfeit activity.

## 8. Pre-Sale Identification of Third-Party Sellers

Stakeholders have, at times, reported that buyers have been surprised to discover upon completion of an online sales transaction, that the order will be fulfilled by an unknown third-party seller and *not* the platform itself. Without addressing the separate legal question of whether this comprises deceptive action *per se*, at least some buyers may have made different purchasing decisions if they

had known, prior to purchase, the identity of the third-party “storefront” owner, and/or the party ultimately responsible for fulfilling the transaction.

To increase transparency on this issue, platforms should significantly improve their pre-sale identification of third-party sellers so that buyers can make informed decisions, potentially factoring in the likelihood of being sold a counterfeit or IPR infringing merchandise. Platforms should implement additional measures to inform consumers, prior to the completion of a transaction, of the identity of storefront owners and/or those responsible for fulfilling a transaction, as well as any allegations of counterfeits being sold by a particular seller. On the converse, if a particular seller is a licensed reseller of the product, this information should also be provided.

Even if this information may be currently available, firm steps should be taken to ensure that this information is featured prominently in product listings. This will prompt greater consumer awareness and lead to more informed decision-making.

#### 9. Establish Marketplace Seller IDs

Platforms generally do not require a seller on a third-party marketplace to identify the underlying business entity, nor to link one seller profile to other profiles owned by that same business, or by related businesses and owners. In addition, the party that appears as the seller on the invoice and the business or profile that appears on the platform to be the seller, may not always be the same. This lack of transparency allows one business to have many different profiles that can appear unrelated. It also allows a business to create and dissolve profiles with greater ease, which can obfuscate the main mechanism that consumers use to judge seller credibility, namely reviews by other buyers.

Platforms should require sellers to provide the names of their underlying business or businesses (if applicable), as well as any other related seller profiles owned or controlled by that seller or that clear transactions through the same merchant account. Platforms can use this seller ID information in three helpful ways:

First, to communicate to the consumer a more holistic view of “who” is selling the goods, allowing the consumer to inspect, and consult reviews of, all related seller profiles to determine trustworthiness. Second, linking all related sellers together will assist rights holders in monitoring who is selling goods that they believe to be infringing. Third, the platform can use the connections to other seller profiles to better conduct its own internal risk assessment, and make risk mitigation decisions (e.g., requiring cash deposits or insurance) as appropriate based on the volume and sophistication of the seller.

#### 10. Clearly Identifiable Country of Origin Disclosures

Brick-and-mortar retail stores are required to have labels on their products that clearly identify the country or countries of origin. No such requirement applies to online e-commerce.

## Exhibit 2

## Fighting China's counterfeits in the online era

Xinhua | Updated: 2017-09-19 14:20



BEIJING - A secret team in Chinese e-commerce giant Alibaba has the task of pretending to be online consumers who test-buy purchases from the billion-plus products on its platforms.

They spot check about 100,000 products and invest around 100 million yuan (\$15.15 million) a year on average. Around one in four online shops are checked annually.

"Spot checks are not random. They are guided by big data from our platforms," said team leader Qin Seng. Using product ratings, consumer disputes and other information, the team builds a model to identify suspected counterfeits and shops that sell counterfeits.

The whole process is videoed to retain evidence. The sample purchases are sent to rights holders or authoritative quality inspection agencies. If identified as fake, the products are removed from the platform. The vendors can face the closure of their online shops. If identified as genuine products, they are stored as Alibaba's assets.

Alibaba's Storehouse of Counterfeit Evidence is a 300-square-meter warehouse in Alibaba Group's Xixi Park, in Hangzhou, Zhejiang province. Counterfeits can be stored there for more than three years as legal evidence.

The spot checks are symptomatic of China's battle against counterfeits in the internet era.

Chai Haitao, deputy director of the Office of National Leading Group of the Fight against IPR Infringement and Counterfeiting, said that with the rapid development of China's internet economy, infringements and counterfeits are constantly renewed.

"We need to strengthen cross-sector, cross-regional, and cross-border cooperation to combat counterfeits. We also need to mobilize enterprises, industry organizations and the public," Chai said.

Alibaba's Anti-Counterfeiting Special Task Force, formed last year, actively works with local law enforcement agencies, said Qin Seng.

"After we clean up online shops selling counterfeits, the counterfeiters usually change their identities and places of dispatch, using more covert means to continue selling online," Qin said.

The team uses big data to identify counterfeits and the vendors, affiliated dealers and factories suspected of producing or selling counterfeit items. They pass evidence to the public security, administration of commerce and industry, quality inspection, food and drug supervision and other law enforcement agencies. At the same time, they investigate the evidence in the field.

The team faces many risks in their offline probes.

"Most counterfeiting dens are hidden and well-organized. For example, we encountered a village producing counterfeits. The villagers installed cameras everywhere and when they saw outsiders entering, they became vigilant and even threatened us," Qin said.

Alibaba's cooperation with local authorities to locate counterfeit sources has proved effective. They have partnerships with the public security bureaus of 13 provinces.

### Most Viewed in 24 Hours

Top 10 most popular online shopping sites in China

Top 10 Chinese internet companies in 2017

Top 14 most powerful female billionaires in the world

Top 10 robotics companies in the world

Top 10 trading partners of the Chinese mainland

### State Council News



State Council hears report on national inspection and third-party assessment



More efforts against money laundering

### Top 10



World's top 10 financial centers

### Editor's picks



Gree denies rumors of seeking stake in automaker FAW Xiali



Australian businesses confident about Chinese economy in next five years

### Timeline of policy supports for the rental home market



Timeline of policy supports for the rental home market

### Q&A With CEO

In 2016, Alibaba submitted 1,184 leads to law enforcement agencies; helped public security bureaus arrest 880 suspects; assisted in the closure of 1,419 counterfeit manufacturing locations; and helped seize merchandise worth more than 3 billion yuan (\$455 million).



Serving in the name of progress

In August, with evidence from Alibaba, police in Loudi, Hunan province, broke up a ring producing and selling counterfeit weight-loss drugs, with a sales network in more than 20 provinces. Total trade by the ring exceeded 100 million yuan (\$15.15 million).



Behind an advertising vision

In the eyes of Sun Jungong, vice president of Alibaba, spot checks and data-driven proactive monitoring protect a good shopping environment on the platform itself, while cooperation with law enforcement agencies shows effective collaborative governance.



Special



2017 Summer Davos



China's Q1 economic data

"We hope to take advantage of Alibaba's big data and strong data-mining capabilities. By expanding offline cooperation, we aim to tackle this issue at its source," Sun said.

Professor Wang Xin, of Peking University Law School, said the rapid development of China's e-commerce platforms and the emergence of new online shopping models have provided more sales channels for fake goods.

Wang said China has made great efforts in recent years to stamp out intellectual property right (IPR) infringements, by improving laws and setting up specialist IPR courts.

However, the penalties for counterfeit producers and sellers are not enough of a deterrent, Wang conceded. Many counterfeit makers receive suspended sentences or fines.

He suggested recidivists should be banned from entering the market again forever.

Alibaba's analysis has also found some online consumers buy counterfeits knowingly.

Sun Jungong said raising awareness among consumers is essential to fight counterfeiting.

"Everyone can do their bit to stop counterfeit goods. If society reaches a consensus, as with drink-driving, we are more likely to tackle this problem," Sun said.

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**Date of Creation:** 2003

**Publication Date Range:** 2003-08-01 to 2003-08-01

**Nation of First Publication:** United States

**Authorship on Application:** General Tools & Instruments LLC, employer for hire; Domicile: United States; Citizenship: United States. Authorship: photographs.

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## Exhibit 5



# Intellectual Property Rights

**Fiscal Year 2018 Seizure Statistics**

*Prepared by*

U.S. Customs and Border Protection  
Office of Trade



Homeland  
Security



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Disclaimer: The information contained in this report does not constitute the official trade statistics of the United States. The statistics, and the projections based upon those statistics, are not intended to be used for economic analysis, and are provided for the purpose of establishing U.S. Department of Homeland Security workload.



## EXECUTIVE SUMMARY

Products that infringe U.S. trademarks and copyrights are subject to exclusion orders issued by the United States International Trade Commission threaten the health and safety of American consumers and pose risks to our national interests. U.S. Customs and Border Protection (CBP) and U.S. Immigration and Customs Enforcement (ICE) Homeland Security Investigations' (HSI) enforcement of intellectual property rights (IPR) mitigates the financial and welfare risks posed by imports of illicit products.

Each year, more than 11 million maritime containers arrive at our seaports. At our land borders, another 10 million arrive by truck and 3 million arrive by rail. An additional quarter billion more cargo, postal, and express consignment packages arrive through air travel. The Department of Homeland Security (DHS) remains vigilant in targeting shipments containing IPR-infringing goods, levying civil fines and criminally investigating those who seek to violate our trade laws, harm consumers, and damage our economy.

In fiscal year (FY) 2018, the number of IPR seizures decreased by 333 seizures to 33,810 from 34,143 in FY 2017. The total estimated manufacturer's suggested retail price (MSRP) of the seized goods, had they been genuine, increased to nearly \$1.4 billion from over \$1.2 billion in FY 2017.

In FY 2018, ICE-HSI arrested 381 individuals, obtained 296 indictments, and received 260 convictions related to intellectual property crimes.

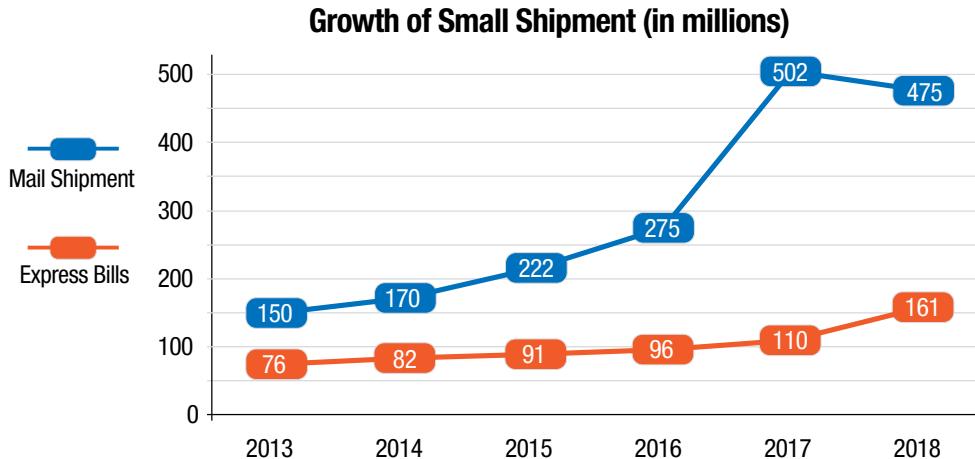


E-commerce sales, including those through third-party platforms, have resulted in a sharp increase in the shipment of small packages into the United States. In FY 2018, there were 161 million express shipments, and 475 million packages shipped through the international mail environment.

Over 90% of all intellectual property seizures occur in the international mail and express environments. A majority of those fall under the de minimis threshold of \$800.

In March 2018, CBP released its CBP E-Commerce Strategy. The strategy strengthens CBP's ability to protect the public and U.S. economy from noncompliant goods. The strategy drives compliance and enforcement, and promotes coordination. CBP is working toward implementation.

More e-commerce related information can be found at  
<https://www.cbp.gov/trade/basic-import-export/e-commerce>



## FISCAL YEAR 2018 IPR SEIZURE STATISTICS BY NUMBER OF SEIZURES



China (Mainland)

Hong Kong

Turkey

India

Taiwan

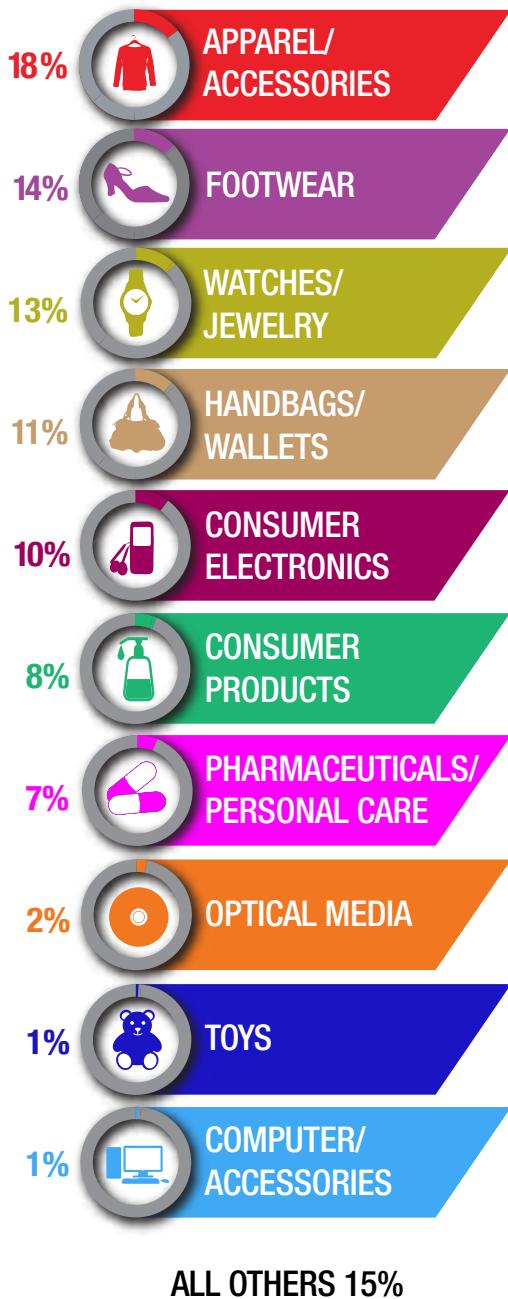
All Other Countries

**FY 2018 TOTALS:**

**33,810 - NUMBER OF SEIZURES**

**\$1,399,873,842 - MSRP**

## TOP PRODUCTS SEIZED BY NUMBER OF SEIZURES



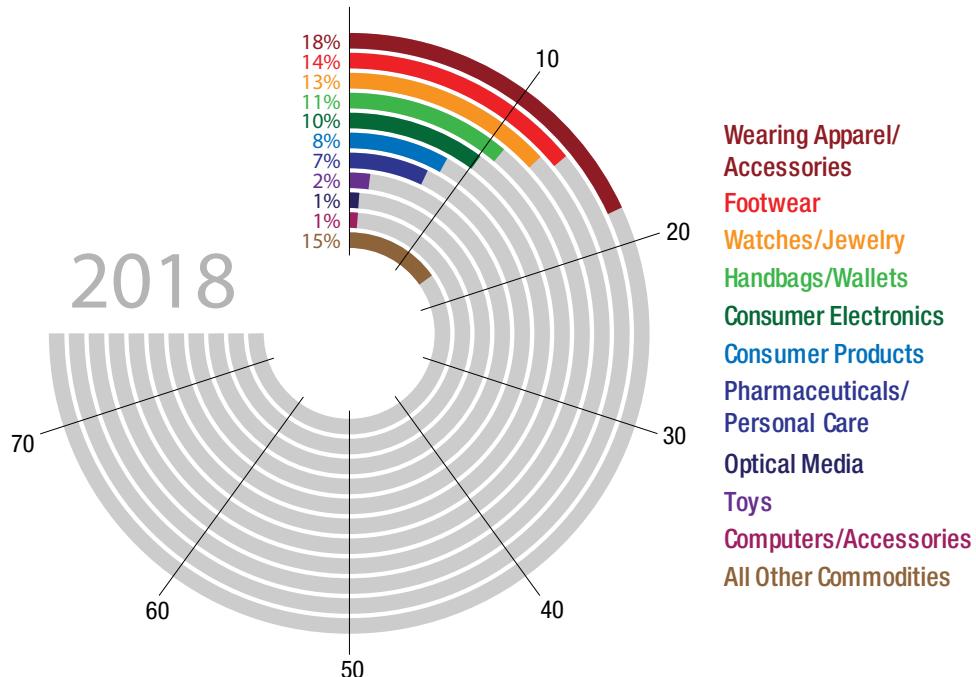
## SHIPPING ENVIRONMENT BY NUMBER OF SEIZURES





## Number of Seizures by Product

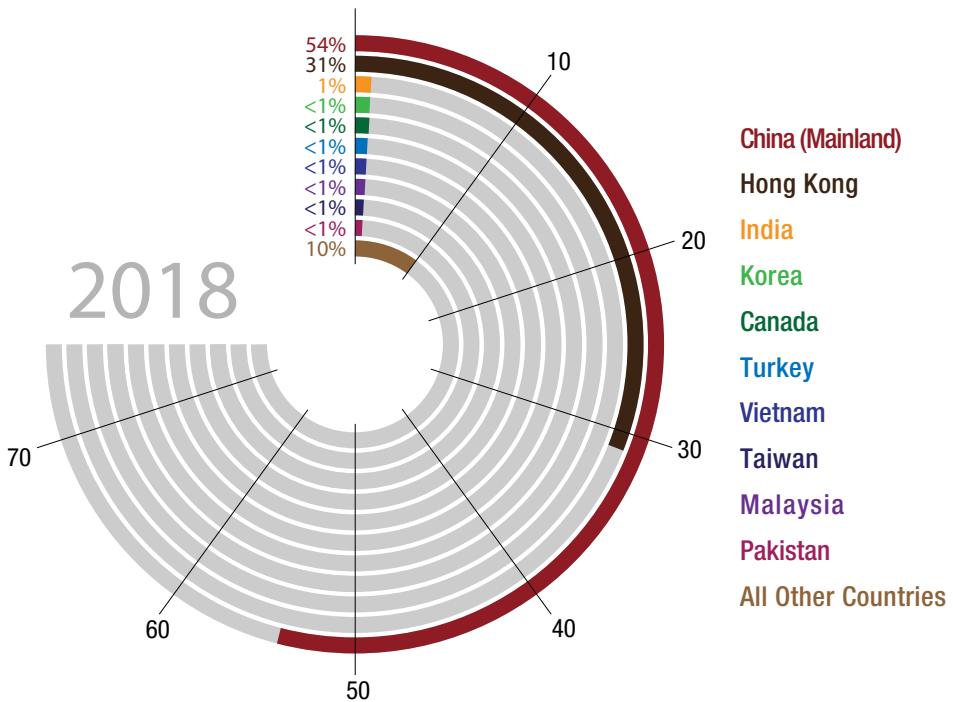
2018



Products	Seizures	% of Total*
Wearing Apparel/Accessories	6,098	18%
Footwear	4,728	14%
Watches/Jewelry	4,291	13%
Handbags/Wallets	3,593	11%
Consumer Electronics	3,388	10%
Consumer Products	2,816	8%
Pharmaceuticals/Personal Care	2,293	7%
Optical Media	561	2%
Toys	487	1%
Computers/Accessories	450	1%
All Other Commodities	5,105	15%
<b>Number of Seizures</b>	<b>33,810</b>	



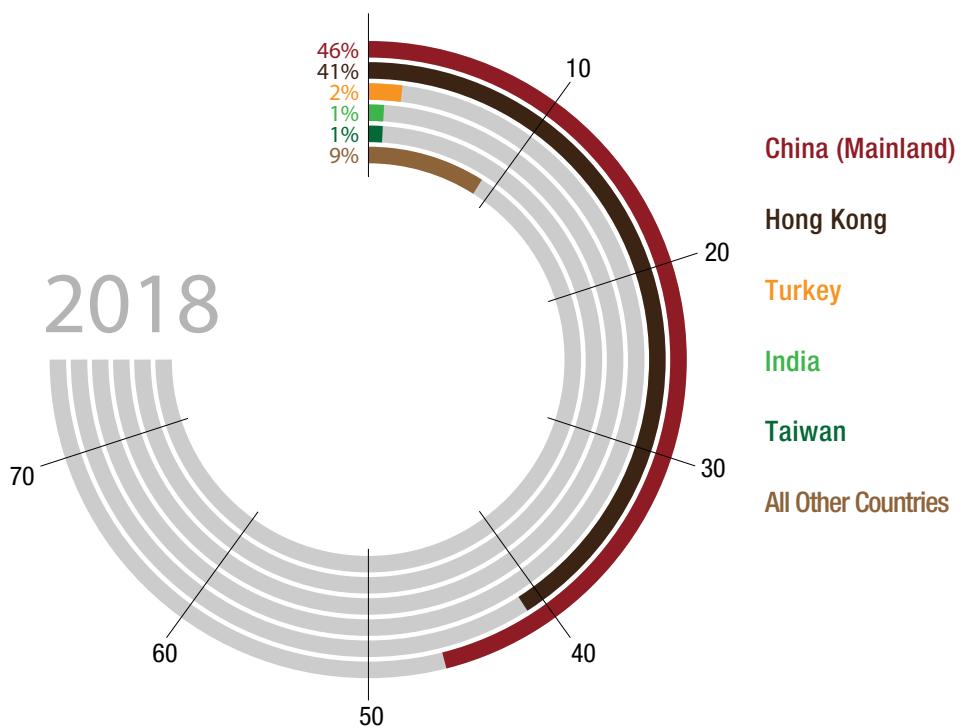
## Total MSRP for Products Seized by Economy



Trading Partner	MSRP	% of Total*
China (Mainland)	\$ 761,115,429	54%
Hong Kong	\$ 440,344,663	31%
India	\$ 19,952,488	1%
Korea	\$ 10,135,531	0.7%
Canada	\$ 7,798,500	0.6%
Turkey	\$ 5,759,008	0.4%
Vietnam	\$ 5,192,261	0.4%
Taiwan	\$ 5,008,077	0.4%
Malaysia	\$ 4,674,447	0.3%
Pakistan	\$ 2,779,413	0.2%
All Other Countries	\$ 137,114,027	10%
Total FY 2018 MSRP	\$ 1,399,873,842	
Number of Seizures		33,810



# Seizures by Economy



## Exhibit 6

## ALIBABA, AMAZON, AND COUNTERFEITING IN THE AGE OF THE INTERNET

Northwestern Journal of International Law & Business (forthcoming 2020)

Daniel C.K. Chow\*

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*The advent of e-commerce marketplaces such as Alibaba and Amazon in the new millennium has led to the proliferation of the sale of counterfeit goods around the world through the Internet. Brand owners find that Internet counterfeiters operating in the digital world present even more challenges than those using only brick and mortar operations. Internet counterfeiters have unprecedented access to consumers, use false identities and addresses, and vanish into cyberspace at the first sign of trouble. Brand owners seeking help from Alibaba and Amazon to remove listings of counterfeits have become frustrated by their convoluted and labyrinthine notice and take-down procedures. Even when these procedures are used successfully, brand owners find that the process can take months only to have the counterfeiter reappear in short order using a new false identity. Many brand owners find that dealing with Alibaba and Amazon only adds to their misery and believe that both tolerate counterfeits as they earn revenue from all sales, including sales of counterfeit goods.*

*This Article sets forth for the first time how brand owners can use a set of currently available information technology tools to help create an effective deterrent to counterfeits on the Internet. Using these tools, brand owners can force counterfeiters to abandon the subterfuge and disguise that they rely on so that brand owners can – without the assistance of e-commerce sites – directly pursue counterfeiters in civil and criminal actions in China where most of the counterfeiters are located and in the United States. The proposed approach should help deter counterfeiters who always work in secrecy and disguise by exposing them to what they fear and loathe the most: transparency and accountability for their illegal actions.*

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\* B.A., JD, Yale University. Bazler Chair in Business Law, The Ohio State University Michael E. Moritz College of Law. The author lived and worked in China as head of the legal department for a multinational company in the consumer products business with serious counterfeiting issues. The author also helped to organize and served as the first executive secretary for the China Anti-Counterfeiting Coalition, a lobby group for multinationals in China (now known as the Quality Brands Protection Committee), and was the principal author of the white paper on counterfeiting in China commissioned by the PRC State Council. More recently, in addition to academic duties, the author served as an attorney and expert witness in U.S. litigation involving the sale of counterfeit cigarettes and Internet e-commerce sites in China and the United States. The opinions expressed in this Article are the author's own but the author has profited from many discussions with colleagues. Thanks to Natasha Landon, Moritz Law Librarian for her excellent research help.

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## I. INTRODUCTION

The advent of Internet commerce in the early 2000s coincided with the unprecedented and historic rise of counterfeiting in the People’s Republic of China (PRC or China) that began in the 1990s.<sup>1</sup> Although sales of counterfeits through brick and mortar establishments had already gained a substantial share of the market in China by the early 2000s,<sup>2</sup> the rise of the Internet in the new millennium has allowed counterfeiters in China unparalleled access to consumers not just in China but also in the United States and worldwide by transcending the physical limitations inherent in the use of brick and mortar operations.<sup>3</sup>

Recent studies show that counterfeits and infringing products have proliferated on the Internet and have reached levels of saturation that were not unattainable by counterfeiters selling through brick and mortar distributors.<sup>4</sup> For example, Xinhua, China’s official news agency stated that more than 40% of all goods sold online through Chinese Internet platforms in a recent year were “counterfeits or of bad quality.”<sup>5</sup> Since Xinhua is controlled by the Communist Party of China

<sup>1</sup> See Daniel C.K. Chow, *Counterfeiting in the People’s Republic of China*, 78 WASH. U. L. Q. 1, 3 (2000) [hereinafter Chow, *Counterfeiting in China*].

<sup>2</sup> By the early 2000s, brand owners estimated that counterfeits comprised 15-20% of all goods sold on the market in China. See *id.* at 3 n.3 (citing Joseph T. Simone, *Countering Counterfeitors*, CHINA BUS. REV., Jan–Feb 1999, at 12).

<sup>3</sup> See U.S. GOV’T ACCOUNTABILITY OFF., GAO-18-216, INTELLECTUAL PROPERTY: AGENCIES CAN IMPROVE EFFORTS TO ADDRESS POSED BY CHANGING COUNTERFEITS MARKET 11 (2018), available at <https://www.gao.gov/assets/690/689713.pdf> (discussing how the use of the Internet allows counterfeiters to transcend limits of brick and mortar counterfeiting) [hereinafter GAO REPORT].

<sup>4</sup> See *infra* Parts II.A & II.B.

<sup>5</sup> Over 40 Per Cent of Goods Sold Online in China Fakes or Poor Quality, Says State Media Report, S. CHINA MORNING POST (Nov. 3, 2015), <https://www.scmp.com/news/china/society/article/>

(the Party) and would want to present China in the best light possible, the 40% figure might underestimate the severity of the problem. Most consumers in China believe that the likelihood of a product sold on the Internet is counterfeit is very high, and those who wish to buy genuine products avoid the use of the Internet altogether.<sup>6</sup> This 40% figure cited by Xinhua is double the estimated 15-20% rate of counterfeits sold in brick and mortar establishments in China.<sup>7</sup> In the United States, the U.S. General Accounting Office recently conducted a study and found that of four types of frequently counterfeited goods (i.e., sneakers, mugs, cosmetics, and phone chargers) purchased online, 27 were authentic and 20 were counterfeit.<sup>8</sup> After Seattle-based Amazon made efforts in 2015 to woo Chinese manufacturers to sell directly on its sites, complaints about counterfeits and infringing products sold on Amazon have risen sharply.<sup>9</sup>

Efforts by multinational companies (MNCs) that own trademarks (or brands), copyrights, and other intellectual property rights to stem the flow of counterfeits through the Internet have been largely unsuccessful, leading to anger and frustration.<sup>10</sup> Under current legal regimes, Internet platforms are in general not liable for counterfeits sold by third-party online vendors using the site;<sup>11</sup> liability lies with the vendor itself, but many brand owners argue that Internet commerce sites facilitate the sales of counterfeits.<sup>12</sup> Internet commerce sites earn revenues from sales, including sales of counterfeits.<sup>13</sup> Many brand owners argue that Internet sites facilitate counterfeiting by allowing webpages or postings of counterfeit goods to remain on their sites despite the many protests of brand owners.<sup>14</sup> Some of these offending webpages are removed after brand owners suffer through a long and convoluted notice and takedown procedure only to

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1875198/over-40-cent-goods-sold-online-china-fakes-or-poor-quality-says. Xinhua does not distinguish between counterfeits and products of poor quality; it is unclear whether Xinhua believes that these are two separate categories of goods or a single category as most counterfeits are of poor quality.

<sup>6</sup> This observation is based upon the author's own experience living and working in China and on discussions with colleagues and associates.

<sup>7</sup> See Chow, *Counterfeiting in China*, *supra* note 1, at 3 n.3.

<sup>8</sup> See GAO REPORT, *supra* note 3, at 15. The products were Nike Air Jordan shoes, Yeti travel mugs, Urban Decay cosmetics, and UL-certified phone chargers. *Id.*

<sup>9</sup> Wade Shepard, *How Amazon's Wooing of Chinese Sellers Is Killing Small American Businesses*, FORBES (Feb. 14, 2017), <https://www.forbes.com/sites/wadeshepard/2017/02/14/how-amazons-wooing-of-chinese-sellers-is-hurting-american-innovation/#13af78741df2>.

<sup>10</sup> See *infra* Parts II.B & II.D.

<sup>11</sup> See The Digital Millennium Copyright Act of 1998 (DMCA), 17 U.S.C. § 512 (2012) (creating a "safe harbor" from vicarious liability for Internet service providers that upon notification remove infringing material expeditiously). For cases holding that the Internet service provider is not vicariously liable for the sale by third party vendors, see generally Milo & Gabby, LLC v. Amazon.com, Inc., 2015 WL 4394673 (W.D. Wash. July 16, 2015); Perfect 10, Inc. v. Amazon.com, Inc., 2009 WL 1334364 (C.D. Cal. May 12, 2009); Hendrickson v. Amazon.com, Inc., 298 F. Supp. 2d 914 (C.D. Cal. 2003).

<sup>12</sup> See *infra* Parts II.B, II.D & II.E.

<sup>13</sup> See David Pierson, *Extra Inventory. More Sales. Lower Prices. How Counterfeits Benefit Amazon*, L.A. TIMES (Sept. 28, 2018), <https://www.latimes.com/business/technology/la-fi-tn-amazon-counterfeits-20180928-story.html> ("Not only has [Amazon] avoided any serious backlash for allowing the sale of fake goods, it's actually thrived from it, say more than two dozen brand owners, e-commerce consultants, attorneys, investigators and public policy experts.").

<sup>14</sup> See *infra* Parts II.D & II.E.

reappear under a new false name and address in short order.<sup>15</sup> In China, MNCs have waged a decades-long struggle against Alibaba to stem the sale of counterfeits with few tangible results.<sup>16</sup> Although Alibaba claims to have made many serious efforts in combatting counterfeiting, many brand owners remain frustrated and dissatisfied.<sup>17</sup> As in the case of Alibaba, brand owners in the United States are frustrated with what they perceive to be Amazon's half-hearted efforts to battle the flow of counterfeits.<sup>18</sup>

This Article examines counterfeiting on the Internet with a focus on Alibaba and Amazon, the largest e-commerce sites in China and the United States respectively and the two largest e-commerce sites in the world.<sup>19</sup> The lessons learned can be immediately applied to other Internet sites. This Article focuses on why the sale of counterfeits on the Internet has exploded and allowed counterfeiters to penetrate markets that were previously unavailable when counterfeiters were limited to brick and mortar operations. Not only has the Internet given counterfeiters vast new opportunities for profit but it has also allowed them to operate in the digital world in the open, while at the same time being able to use false cyber identities and addresses to evade detection and capture by brand owners and law enforcement authorities.<sup>20</sup> With the emergence of the Internet, counterfeiting and piracy—already a worldwide problem—has entered into a new and even more potent phase.<sup>21</sup> Up to the present, MNCs have been frustrated by their inability to blunt the growth of counterfeits on the Internet.<sup>22</sup>

Although the problems created by the Internet are daunting, this Article argues that a simple and effective deterrent exists in China but has been overlooked or ignored by MNCs and Internet commerce sites and explains how this deterrent can be used effectively. This Article sets forth for

<sup>15</sup> See Pierson, *supra* note 13 (“[I]f Amazon shutters one store for selling knockoffs, the owner often shifts operations to another.”); Alana Semuels, *Amazon May Have a Counterfeit Problem*, THE ATLANTIC (Apr. 20, 2018), <https://www.theatlantic.com/technology/archive/2018/04/amazon-may-have-a-counterfeit-problem/558482/> (“These problems come up once a week.”). Cf. Jeff Bercovici, *Huge Counterfeiting Problem. This “Shark Tank” Company Is Fighting Back*, INC.COM (Apr. 2019), <https://www.inc.com/magazine/201904/jeff-bercovici/amazon-fake-copycat-knockoff-products-small-business.html> (“A recent Pointer report noted that Amazon is among the least responsive of all e-commerce platforms to takedown notices, removing only 25 percent of infringing listings.”).

<sup>16</sup> See *infra* Part II.D.

<sup>17</sup> See *id.*

<sup>18</sup> According to one brand owner representative, “Amazon is making money hand over fist from counterfeiters and they’ve done about as little as possible for as long as possible to address the issue.” Ari Levy, *Amazon’s Chinese Counterfeit Problem Is Getting Worse*, CNBC (July 8, 2016), <https://www.cnbc.com/2016/07/08/amazons-chinese-counterfeit-problem-is-getting-worse.html>. See also *supra* note 15 (describing Amazon’s low level of responsiveness to brand owner concerns).

<sup>19</sup> Alibaba is the world’s largest e-commerce marketplace and Amazon is the second largest. See *infra* notes 103 & 107.

<sup>20</sup> See Pierson, *supra* note 13.

<sup>21</sup> See BUSINESS ACTION TO STOP COUNTERFEITING AND PIRACY, INTERNATIONAL CHAMBER OF COMMERCE, ROLES AND RESPONSIBILITIES OF INTERMEDIARIES: FIGHTING COUNTERFEITING AND PIRACY IN THE SUPPLY CHAIN 5 (2015), available at <https://iccwbo.org/publication/roles-responsibilities-intermediaries/> (“The Internet has been particularly vulnerable . . . to counterfeiters and other criminal capitalizing on the success (and intellectual property) of legitimate businesses while remaining anonymous and avoiding detection.”).

<sup>22</sup> See *infra* Part III.

the first time how these remedial measures can be used to blunt the explosion of counterfeits on the Internet. In setting forth this analysis, this Article will underscore the following three major points that must be understood by all MNCs and other brand owners in modern e-commerce.

First, the emergence of Internet commerce sites such as Alibaba and Amazon have given counterfeiters a vast new tool to reach end use consumers. Prior to the Internet, counterfeiters were subject to the physical limitations created by brick and mortar distribution and retail sites and were unable to penetrate distribution channels that would allow them to sell counterfeits in reputable retail outlets.<sup>23</sup> Consumers had to travel to less desirable locations to buy counterfeits as state-owned department stores and high end retailers in China and large reputable retail chains such as Walmart, Target, and Costco in the United States refused to deal with distributors of counterfeit goods.<sup>24</sup> Instead, consumers in China or the United States who wished to purchase counterfeits had to go to small discount stores, mom and pop stores, flea markets, street vendors, or private addresses in side streets, back alleys or other undesirable locations, a prospect that deterred many consumers.<sup>25</sup> The emergence of the Internet has now given what counterfeiters have always sought: a legitimate distribution channel that consumers can access at any time from their computers without having to travel to undesirable locations to buy counterfeits from brick and mortar sellers.<sup>26</sup> The Internet also gives counterfeiters the ability to disguise their identities and to disappear into the vastness of cyberspace at the first sign of trouble.<sup>27</sup> All counterfeiters and pirates, whether they sell in brick and mortar locations or through the Internet, are very fearful of detection and capture.<sup>28</sup> Counterfeiters that use brick and mortar establishments are subject to surprise raids and seizures by enforcement authorities,<sup>29</sup> but Internet counterfeiters have found ways to use false identities that are untraceable by brand owners; even when they are detected, Internet pirates that are shut down are able to immediately create new false identities and return to their illegal operations on the Internet.<sup>30</sup>

Second, PRC enforcement officials have recently acknowledged in an official report that Alibaba sees itself as above the law in China and feels no need to follow it.<sup>31</sup> MNCs have long

<sup>23</sup> See GAO REPORT, *supra* note 3, at 11.

<sup>24</sup> This observation is based on the author's own experience as an attorney working for U.S. brand owners in tracking the distribution channel of counterfeits.

<sup>25</sup> *Id.* See GAO REPORT, *supra* note 3, at 10 (counterfeits were traditionally sold in "underground" or secondary markets such as flea markets or sidewalk vendors).

<sup>26</sup> See GAO REPORT, *supra* note 3, at 11–12.

<sup>27</sup> See *id.*

<sup>28</sup> This observation is based on the author's firsthand experience in pursuing counterfeiters.

<sup>29</sup> See Chow, *Counterfeiting in China*, *supra* note 1, at 19–21 (describing raids conducted in Yiwu City, "a significant wholesale distribution center for counterfeit goods in the PRC[.]" from 1998 to 1999).

<sup>30</sup> See Pierson, *supra* note 13 ("[B]rands say the same fraudsters keep showing up under different names[.]"); Semuels, *supra* note 15 ("Milo and Gabby tried to track down the [counterfeit] sellers, but almost all of the sellers had given false names when setting up their Amazon seller accounts, and the addresses they gave turned out to be bogus as well[.]").

<sup>31</sup> See STATE ADMIN. OF INDUS. & E-COMMERCE, PEOPLE'S REPUBLIC OF CHINA, WHITE PAPER ON ALIBABA GROUP HOLDINGS ADMINISTRATIVE GUIDANCE WORK SITUATION (Jan. 28, 2015) [hereinafter SAIC WHITE PAPER]. A partial English translation is available at Zheping Huang, *The Chinese Government Has Erased a Damning Report on Alibaba, But You Can Read It Here*, QUARTZ (Jan. 29, 2015), <https://qz.com/335675/the-chinese-government-has-erased-a-damning-report-on-alibaba-but-you-can-read-it-here/>. The SAIC White Paper is extensively discussed in Part II.B.

suspected that Alibaba tolerates or encourages counterfeiting on its sites.<sup>32</sup> Brand owners have persistently complained that Alibaba and Amazon appear reluctant to assist brand owners in tracking down counterfeiters and create unnecessary bureaucratic and technical hurdles in the detection of counterfeiters.<sup>33</sup> Some brand owners have attributed these difficulties to an economic motive: Internet commerce sites earn revenue through sales, including sales of counterfeit goods.<sup>34</sup> In the case of Alibaba, brand owners have long suspected that it tolerates or supports counterfeiting and these sentiments have been confirmed by official statements by PRC enforcement authorities. According to PRC officials, Alibaba's attitude towards the law and enforcement authorities is marked by a fundamental "arrogance."<sup>35</sup> In China, it is not unusual for powerful entities to view themselves as above the law.<sup>36</sup> The Communist Party, the most powerful entity of all, sees the law as a mere instrument to be used to serve the ends of the Party.<sup>37</sup> Alibaba is not intimidated by or fearful of law enforcement authorities; to the contrary, Alibaba sees itself as more powerful than government law enforcement authorities and answerable only to the Party.<sup>38</sup> For these reasons, MNCs must accept the reality that Alibaba, the words of PRC officials, tolerates and supports counterfeiters in order to protect its revenues from sales of counterfeit goods and that it will likely take an intervention by the Party at its highest levels to effect meaningful change in Alibaba's conduct. Any plan to stem the sales of counterfeits on Alibaba's sites that requires Alibaba's active participation must proceed with the assumption that it will be met with resistance or efforts that are half-hearted.

Third, although the use of the Internet to sell counterfeits presents formidable new challenges to brand owners, this Article argues that simple and effective measures are available under PRC law to brand owners to deter many counterfeiters from using the Internet and to detect and identify those that do.<sup>39</sup> This Article proposes and sets forth for the first time a set of simple and effective methods that MNCs can use to create effective deterrence to counterfeiting on the Internet.<sup>40</sup> To the best of the author's knowledge, no MNC, brand owner, or any professional or academic study has previously identified these methods, although they are openly available and in plain sight in China's legal system and their use is required and regularly encouraged by PRC officials. Although certain aspects of China's information technology industry, such as protection and enforcement of intellectual rights, are weak by comparison to the United States other aspects of China's information technology industry are far ahead of the United States.<sup>41</sup> In particular,

<sup>32</sup> See *infra* Part II.B.

<sup>33</sup> See *infra* Part III.A.

<sup>34</sup> See e.g., Pierson, *supra* note 13 ("Not only has [Amazon] avoided any serious backlash for allowing the sale of fake goods, it's actually thrived from it, say more than two dozen brand owners, e-commerce consultants, attorneys, investigators and public policy experts.").

<sup>35</sup> SAIC WHITE PAPER, *supra* note 31, at 20.

<sup>36</sup> See *infra* Part II.D.2.b.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> See *infra* Part III.

<sup>40</sup> *Id.*

<sup>41</sup> China is far ahead of the U.S. in the use of technologies, such as facial recognition, to closely monitor its citizens. See Zhou Jiaquan, *Drones, Facial Recognition, and a Social Credit System: 10 Ways China Monitors Its Citizens*, S. CHINA MORNING POST (Aug. 4, 2018), <https://www.scmp.com/news/china/society/article/2157883/drones-facial-recognition-and-social-credit-system-10-ways-china>.

China's obsessive need to exert pervasive control over and to monitor its citizens and all aspects of Chinese society have created the informational technology tools available to deter counterfeiters.<sup>42</sup> In fact, Chinese government officials have urged Internet sites to use the tools available to control entry onto Internet sites and to monitor entities on the Internet.<sup>43</sup> Brand owners, however, either do not trust PRC officials or understand the potential effectiveness of these tools.

Unlike brick and mortar counterfeiters who need no permission to operate, counterfeiters must obtain pass through a digital port of entry in order to obtain access to the Internet to sell their products.<sup>44</sup> Operators of Internet websites have the ability to exercise absolute control over entry. Controlling this point of entry through the use of tools created by the PRC government is the key to controlling counterfeiting on the Internet. Counterfeiters wish to operate in hiding and secrecy; they fear and detest transparency and accountability. Internet commerce sites can remove the anonymity of the Internet by following a straightforward registration system as required by PRC law.<sup>45</sup> However, Alibaba does not faithfully apply the requirements of PRC law but instead is careless and loose in verifying entity registration.<sup>46</sup> Brand owners also complain that Amazon has lax registration requirements and registers many entities with fictitious identities and addresses.<sup>47</sup>

As a condition of gaining access to e-commerce sites, PRC law requires all vendors to submit a business license issued by PRC government authorities that will reveal their true legal identities and locations in strict accordance with the detailed and specific information contained in official PRC government records and available electronically on government websites to the public.<sup>48</sup> To obtain this official business license, business operators must undergo a review and approval by PRC government authorities of the legality and economic feasibility of their proposed business operations.<sup>49</sup> Most counterfeiters will not wish to submit to such an approval process for fear of being detected and being subject to capture and prosecution. Those entities that do undergo this official review will then need to openly display their business licenses on the website, which will allow brand owners on their own and without the need to enlist help from Alibaba or Amazon, to bring criminal and civil actions directly against counterfeiters who will be unavailable to escape detection.<sup>50</sup>

<sup>42</sup> China closely monitors its citizens. Recently, China announced a “social credit” system in which the activities of each citizen will be ranked, and each citizen given a score evaluating the social merit of his or conduct. On how China monitors its citizens, see Charlie Campbell, *How China Is Using “Social Credit Scores” to Rewards and Punish Its Citizens*, TIME (Jan. 16, 2019), <https://time.com/collection/davos-2019/5502592/china-social-credit-score/>.

<sup>43</sup> See *infra* Part III.

<sup>44</sup> Online vendors are required by Internet e-commerce sites to register before they are allowed to access the site. See e.g., *Selling on Amazon: Frequently Asked Questions*, AMAZON, <https://services.amazon.com/selling/faq.htm> (last visited July 1, 2019) (requiring a business name, address, and contact information among other information in order to open an Amazon seller account).

<sup>45</sup> See *infra* Part III.

<sup>46</sup> See *infra* note 97.

<sup>47</sup> See *infra* note 189.

<sup>48</sup> See Administrative Measures for Online Trading, art. 23 (promulgated by the State Admin. of Indus. & E-Commerce, Order No. 60, Jan. 1, 2014, effective Mar. 15, 2014), CLI.4.218557(EN) (China). See also *infra* Part III.

<sup>49</sup> See *infra* Part III.

<sup>50</sup> *Id.*

A unique concept of PRC law is that each business entity must have a natural person who serves as its legal representative and who is subject to civil liability and criminal prosecution.<sup>51</sup> The legal representative must be identified in the business license so brand owners will have a flesh and blood person against whom they can directly file civil or criminal actions in China or in the United States if U.S. contacts exist.<sup>52</sup>

The faithful execution of these requirements should help brand owners to deter many counterfeiters from selling through Internet sites. Currently, however, brand owners did not insist on these requirements and neither Alibaba nor Amazon faithfully follows PRC law on entity registration.<sup>53</sup>

This Article will proceed as follows. Part II examines the background of counterfeiting in China and how the advent of the Internet has propelled this illegal activity to new heights. The ability to transcend the physical limitations created by brick and mortar counterfeiting operations has created a vast new opportunity in cyberspace for counterfeiters who can now compete directly with genuine goods and vanish at the first sign of trouble. Part II also discusses brand owner concerns about Alibaba and Amazon. In the case of Alibaba, brand owners have long claimed that Alibaba tolerates or supports counterfeiting on its websites. A recent in-depth investigation and report by PRC national authorities not only confirms this suspicion but also sets forth the PRC government's own view that Alibaba sees itself as being above the law. Brand owners have also complained that Amazon is unresponsive to their concerns about counterfeits and has byzantine notice and take down procedures that only add to their misery. Part III examines the hurdles that brand owners claim that they face in attempting to work with Alibaba and Amazon in removing infringing webpages or postings from their sites; these frustrations are due to cumbersome notice and takedown procedures that can take months and tax brand owners through heavy costs in time, energy, and money. Part III then sets forth this Article's proposed method of using existing online tools in the PRC to help create deterrents to counterfeiting on the Internet. These tools can be used to combat counterfeits on Alibaba and Amazon as well as on other internet commerce sites. Part IV contains concluding observations.

## II. COUNTERFETING AND THE INTERNET

### A. Brief Overview of Counterfeiting in China

As early as 2000, China was described as having the most serious counterfeiting problem in world history.<sup>54</sup> The origin of this problem can be traced to China's access to advanced technology (i.e. intellectual property) brought into China by MNCs that make foreign direct investments in China and to China's weak and developing legal system,<sup>55</sup> which does not create

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<sup>51</sup> See General Principles of the Civil Law of the People's Republic of China, ch. III, art. 57 (promulgated by the Nat'l People's Cong., Order No. 66, March 15, 2017, effective October 1, 2017) [hereinafter General Principles of the Civil Law of the PRC].

<sup>52</sup> See *infra* Part III.

<sup>53</sup> *Id.*

<sup>54</sup> Chow, *Counterfeiting in China*, *supra* note 1, at 3. The background and history of the rise of counterfeiting before the advent of the Internet is set forth in this article. See *infra* Parts II.A & II.B.

<sup>55</sup> DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS 537–38 (3d. ed. 2015).

effective deterrence for counterfeiters and infringers of intellectual property rights.<sup>56</sup> Although U.S. companies have made many efforts through the first two decades of the twenty-first century to combat counterfeiting in China, China remains today the largest source of counterfeits in the world. For example, a recent study cited in Forbes indicates that China produces 80% of the world's counterfeits and that counterfeiting is now a \$1.7 trillion per year industry.<sup>57</sup> The U.S. General Accountability Office reports that in 2016, 88% of all seized counterfeit goods by the United States originate from China and Hong Kong.<sup>58</sup> The European Union claims that China is the largest source of counterfeit goods sold into the EU.<sup>59</sup> Counterfeiting is now the largest criminal enterprise in the world,<sup>60</sup> and China is the epicenter of counterfeiting.<sup>61</sup> The highest number of shipments of counterfeits seized around the world originates from East Asia, with China as the top source.<sup>62</sup>

On April 3, 2019, the Trump Administration issued a Presidential Memorandum announcing that combatting counterfeiting and piracy had been elevated to a new level of priority for the United States.<sup>63</sup> The memorandum specifically tasked the Justice Department and the Department of Homeland Security to focus on and investigate "online third party marketplaces".<sup>64</sup> This indicates a recognition by the United States that counterfeiting on e-commerce sites is a specialized priority area of concern.

#### B. The Advent of the Internet

The rise of Internet sales platforms in the early 2000s created a valuable new opportunity for counterfeiters. To understand the significance of this development, it is necessary to recognize that there are two main components to counterfeiting: manufacture and distribution.<sup>65</sup>

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<sup>56</sup> DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL TRADE LAW 643 (3d ed. 2017) (China's weak legal system does not create effective deterrence.).

<sup>57</sup> Wade Shepard, *Meet the Man Fighting America's Trade War Against Chinese Counterfeits (It's Not Trump)*, FORBES (Mar. 29, 2018), <https://www.forbes.com/sites/wadeshepard/2018/03/29/meet-the-man-fighting-americas-trade-war-against-chinese-counterfeits/#321a1941c0d6>.

<sup>58</sup> GAO REPORT, *supra* note 3, at 13.

<sup>59</sup> EUROPEAN COMMISSION, EU SEIZURES AT THE BORDER OF GOODS INFRINGING ON INTELLECTUAL PROPERTY RIGHTS (2018), available at [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/factsheet\\_ipr\\_report\\_2018\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/factsheet_ipr_report_2018_en.pdf).

<sup>60</sup> See Shepard, *supra* note 57 ("The trade in counterfeit and pirated goods is currently at \$1.7 trillion . . . and is expected to grow to \$2.8 trillion and cost 5.4 million jobs by 2022.").

<sup>61</sup> See *id.* See also EUROPEAN COMMISSION, *supra* note 57 (reporting that China and Hong Kong, together, accounted for over 83% of counterfeit goods).

<sup>62</sup> OECD & EU INTELLECTUAL PROP. OFFICE, TRADE IN COUNTERFEIT AND PIRATED GOODS: MAPPING THE ECONOMIC IMPACT 49 (2016), available at <http://dx.doi.org/10.1787/9789264252653-en>.

<sup>63</sup> President Donald J. Trump, Memorandum on Combatting Trafficking in Counterfeit and Pirated Goods (Apr. 3, 2019), available at <https://www.whitehouse.gov/presidential-actions/memorandum-combating-trafficking-counterfeit-pirated-goods/>.

<sup>64</sup> *Id.*

<sup>65</sup> Daniel C.K. Chow, *Organized Crime, Local Protectionism and the Trade in Counterfeit Goods in China*, 14 CHINA ECON. REV. 473, 474 (2003).

The manufacture of counterfeits tends to arise in proximity to the manufacture of genuine goods.<sup>66</sup> In the early 1990s, one of the first areas open to foreign investment in China was in the southern region of Guangdong Province, near Hong Kong. MNCs opened manufacturing facilities in special economic zones that created financial incentives for investment.<sup>67</sup> Soon after these facilities were established, the brand owners found that counterfeits began to appear in the same locations.<sup>68</sup> MNCs discovered that employees working in their facilities or their relatives, friends, or associates had begun to use the know-how that they acquired from the MNC to establish their own manufacturing operations in order to produce counterfeits.<sup>69</sup>

A counterfeiter that has manufactured a fake good must still sell it to consumers. The illegal factory may be located far away from densely populated urban areas where large numbers of consumers are found, so the counterfeiter must find a distribution channel for the goods to reach the end use consumer. Distribution is the second major component of counterfeiting.

Prior to the rise of the Internet, counterfeiters faced a problem: legitimate distributors would have nothing to do with counterfeits.<sup>70</sup> MNCs distribute their products in China only through qualified distributors that are able to sell to high-end state-owned department stores and other retail outlets in high-end shopping centers.<sup>71</sup> Qualified distributors are those entities that are able to pass a stringent set of criteria established by brand owners.<sup>72</sup> These distributors will not work with counterfeiters for fear of losing their contracts with legitimate brand owners, and, as a result, counterfeiters are unable to penetrate into legitimate distribution channels to reach high-end retailers.<sup>73</sup> Rather, counterfeiters had to rely on brick and mortar wholesale distributors of lesser and questionable repute who would be willing to sell counterfeits, smuggled goods, and inferior quality products.<sup>74</sup> These wholesale distributors are found in markets in China that are either enclosed or open air spaces with hundreds or thousands of wholesale vendors.<sup>75</sup> Retailers appear at these wholesale markets with trucks or vans to transport the counterfeits purchased at these markets.<sup>76</sup> Large reputable retailers, such as state-owned department stores, do not buy at these wholesale markets.<sup>77</sup> Only retailers that are small mom and pop stores, street stalls, or open air vendors in China will purchase from these markets.<sup>78</sup> This left the counterfeiter with the problem that it could almost never penetrate into high-end retail stores.<sup>79</sup> Purchasers of counterfeits would have to travel to side streets, back alleys, and other areas in less desirable urban locations to buy

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> See *id.* at 474–75.

<sup>69</sup> This observation is based upon the author’s own experience working as in-house counsel for an MNC with major operations in China. It is a pattern that is repeatedly occurs in China: counterfeiting tends to arise in locations with legitimate manufacturing operations.

<sup>70</sup> See Chow, *supra* note 65, at 476.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> See *id.* at 476–77.

<sup>75</sup> *Id.* at 476.

<sup>76</sup> See Chow, *supra* note 65, at 476.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

counterfeits from small and less reputable retailers.<sup>80</sup> The need to travel to unsavory locations deterred many consumers.

In the United States, counterfeits are also unable to penetrate into legitimate distribution channels to reach large department stores or other large retailers.<sup>81</sup> Counterfeits are almost never found in large chain stores such as Costco, Target, or Walmart. These companies either use qualified distributors or have vertically integrated business models that allow them to control distribution themselves.<sup>82</sup> These distributors refuse to deal in counterfeits, smuggled goods, or gray market goods.<sup>83</sup> Only less reputable distributors will deal in these secondary goods, but they do not sell to large and high end retailers who refuse to deal with them.<sup>84</sup> These distributors sell to discount stores, small mom and pop stores, street vendors, or private persons who arrange for sales through word of mouth.<sup>85</sup>

The advent of the Internet has now given counterfeiters what they have long sought: a legitimate and broad-reaching distribution channel to reach retail consumers who are now able to purchase products without having to travel to specific and undesirable locations where counterfeits are sold. Counterfeiters can now place their products on the Internet to reach consumers worldwide and are no longer confined to using illegal wholesale markets to reach lower retail quality stores. While in the past, consumers would not encounter counterfeits on the next shelf adjacent to authentic goods in brick and mortar stores because high end retailers refused to deal with distributors of counterfeit goods, the same is no longer true on the Internet. It is now possible for counterfeits to be on the digital shelf next to genuine goods on the same or an adjacent webpage.<sup>86</sup> Counterfeits can now compete directly with genuine goods.<sup>87</sup> Counterfeiters can also use false digital images that hide the low quality of their goods in competition with genuine goods.<sup>88</sup>

The rise of counterfeits coincides with shifts in consumer habits. In June 2000, approximately 22% of U.S. consumers purchased goods online, but by December 2016 that portion

<sup>80</sup> *Id.*

<sup>81</sup> This observation is based on the author's own experience as an expert witness in U.S. litigation involving U.S. multinational companies in cases involving counterfeits from China.

<sup>82</sup> *Id.*

<sup>83</sup> Gray market goods (sometimes also called parallel imports) are genuine goods that are intended for sale in a foreign market but that are purchased abroad and shipped back to the home market. For example, genuine goods that are sold by the manufacturer to Japan are purchased by a foreign distributor in Japan who then resells them to an importer in China. The foreign distributor is able to take advantage of a lower price in Japan or favorable currency exchange rates in order to sell the products in China at a price that is lower than the genuine goods are sold directly by the manufacturer to buyers in China. See CHOW AND SCHOENBAUM, *supra* note 55, at 567-68.

<sup>84</sup> See Chow, *supra* note 65, at 476.

<sup>85</sup> *Id.*

<sup>86</sup> See GAO REPORT, *supra* note 3, at 11.

<sup>87</sup> *Id.* ("In the past, consumers could often rely on indicators such as appearance, price, or location of sale to identify counterfeit goods in the marketplace, but counterfeiters have adopted new ways to deceive customers.").

<sup>88</sup> *Id. Cf. id.* ("The physical appearance of counterfeit goods may no longer serve as a 'red flag' for consumers that the good they are considering purchasing is not genuine. Counterfeit goods and their packaging are becoming more sophisticated and closely resemble genuine goods[.]").

had risen to 79%.<sup>89</sup> By 2020, worldwide e-commerce sales are expected to reach \$4 trillion, and e-commerce is expected to reach nearly 15% of global retail spending by 2020.<sup>90</sup>

Prior to the advent of the Internet, counterfeiters in China that sought to sell their goods in the United States loaded the goods in large shipping containers with false documentation to transport the goods by ocean carriage to a port in the United States.<sup>91</sup> While detection was difficult, if a brand owner had reliable specific intelligence of an illegal shipment,<sup>92</sup> customs authorities in the United States would open and inspect the container.<sup>93</sup> With Internet sales, thousands or hundreds of thousands of small, individual packages are now shipped to the United States by mail, making it nearly impossible to detect and stop these shipments.<sup>94</sup>

Not only do internet sites allow counterfeiters unprecedented access to end use consumers, counterfeiters are also able to take advantage of the anonymity of the internet to evade capture and detection by using false identities, business names, and locations.<sup>95</sup> The Internet has created an irresistible new opportunity for counterfeiters and has opened vast new avenues for generating profit.

### C. Liability Regimes for Internet Service Providers

Under the Digital Millennium Copyright Act (DMCA)<sup>96</sup> in the United States and similar provisions in China,<sup>97</sup> Internet service providers (ISPs) are not directly liable for the sale of

<sup>89</sup> *Id.* at 12.

<sup>90</sup> *Id.*

<sup>91</sup> See Chow, *supra* note 65, at 475.

<sup>92</sup> Such intelligence can be gathered through the use of private investigation companies that penetrate counterfeit rings. A number of companies, such as Kroll and Pinkerton, specialized in these investigations.

<sup>93</sup> The author was involved as an attorney in a counterfeiting case in the United States in which U.S. Customs authorities stated that they would be willing to conduct an inspection of shipping containers but only on the basis of reliable specific information.

<sup>94</sup> See Pierson, *supra* note 13 (“Customs agents had a fighting chance when pirated goods predominantly arrived in cargo containers. But with the rise of e-commerce, counterfeiters and their middlemen can ship goods in parcels too innumerable to catch.”).

<sup>95</sup> See *id.* (“[B]rands say the same fraudsters keep showing up under different names[.]”); Semuels, *supra* note 15 (“Milo and Gabby tried to track down the [counterfeit] sellers, but almost all of the sellers had given false names when setting up their Amazon seller accounts, and the addresses they gave turned out to be bogus as well[.]”).

<sup>96</sup> 17 U.S.C. § 512 (2012). The DMCA implements two World Intellectual Property Organization (WIPO) treaties: the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. WIPO Copyright Treaty, Dec. 20, 1996, 2186 U.N.T.S. 121; WIPO Performances and Phonograms Treaty, Dec. 20, 1996, 2186 U.N.T.S. 203. As of 2007, the United States and the People’s Republic of China are now contracting parties to both treaties. *Contracting Parties – WIPO Copyright Treaty*, WIPO, [https://www.wipo.int/treaties/en>ShowResults.jsp?lang=en&treaty\\_id=16](https://www.wipo.int/treaties/en>ShowResults.jsp?lang=en&treaty_id=16) (last visited July 1, 2019); *Contracting Parties – WIPO Performances and Phonograms Treaty*, WIPO, [https://www.wipo.int/treaties/en>ShowResults.jsp?lang=en&treaty\\_id=20](https://www.wipo.int/treaties/en>ShowResults.jsp?lang=en&treaty_id=20) (last visited July 1, 2019).

<sup>97</sup> See generally Trademark Law of the People’s Republic of China (promulgated by the Nat’l People’s Cong., adopted Aug. 23, 1982, most recently revised Apr. 23, 2019, effective Nov. 1, 2019); Law

counterfeits listed on their sites by third-party vendors.<sup>98</sup> While ISPs may be subject to vicarious liability for facilitating the sales, the DCMA provides a “safe harbor.”<sup>99</sup> ISPs are entitled to immunity from vicarious liability for third-party listings and sales of counterfeit goods if they have no knowledge of the infringing material and remove it expeditiously upon receiving notice of its illegal nature.<sup>100</sup> To implement the DCMA and corresponding PRC law, e-commerce companies such as Alibaba and Amazon have set forth internal notice and takedown procedures that brand owners are required to follow when they find infringing material.<sup>101</sup> As detailed in a later section, brand owners often complain that these procedures are cumbersome, time consuming, and ineffective.<sup>102</sup>

#### D. *Alibaba*

##### 1. *Brand Owner Concerns*

Alibaba is currently the world’s largest e-commerce platform in the world.<sup>103</sup> In 2016, Alibaba’s Internet marketplaces in China had 423 million active purchasers with a combined gross merchandise volume (GMV) of \$485 billion.<sup>104</sup> In 2018, in the span of just two years, active purchasers in China grew to 636 million and GMV grew to exceed \$768 billion,<sup>105</sup> creating the prospect that Alibaba’s users may soon surpass 1 billion and its GMV may soon surpass \$1 trillion, numbers that seemed almost inconceivable just a decade ago. In 2015, transactions on Alibaba e-commerce sites in China averaged 30 million per day.<sup>106</sup> The sheer size and scope of Alibaba’s operations dwarfs even that of its closest competitors. For example, Alibaba’s GMV in 2018 at \$768 billion is more than three times that of Amazon, the world’s second e-commerce platform, at \$239 billion.<sup>107</sup>

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Against Unfair Competition of the People’s Republic of China (promulgated by the Nat’l People’s Cong., Order No. 10, Sept. 2, 1993, revised Nov. 4, 2017, amended Apr. 23, 2019).

<sup>98</sup> See 17 U.S.C. § 512(c)(1).

<sup>99</sup> *Id.* See generally Susanna Monseau, *Fostering Web 2.0 Innovation: The Role of the Judicial Interpretation of the DMCA Safe Harbor, Secondary Liability and Fair Use*, 12 J. MARSHALL REV. INTELL. PROP. 70 (2012).

<sup>100</sup> See 17 U.S.C. § 512(c)(1).

<sup>101</sup> See *Intellectual Property Policy for Sellers*, AMAZON, <https://sellercentral.amazon.com/gp/help/external/201361070> (last visited July 1, 2019); *Intellectual Property Rights (IPR) Protection Policy*, ALIBABA, <https://rule.alibaba.com/rule/detail/2049.htm> (last visited July 1, 2019).

<sup>102</sup> See *infra* Part III.

<sup>103</sup> Special 301 Out-of-Cycle Review Notorious Markets (Docket Number USTR-2016-2013): Comments Submitted by Alibaba Group, at 2 (Oct. 7, 2016) (correspondence from Eric Pelletier, Vice President of Alibaba, to the Honorable Probir Mehta, Assistant United States Trade Representative).

<sup>104</sup> *Id.*

<sup>105</sup> Press Release, Alibaba Group Announces December Quarter 2018 Results (Jan. 30, 2019), available at [https://www.alibabagroup.com/en/news/press\\_pdf/p190130.pdf](https://www.alibabagroup.com/en/news/press_pdf/p190130.pdf).

<sup>106</sup> Jen Wieczner, *Alibaba: Here’s Why Our Mind-Blowing Numbers Are Real*, FORTUNE (Sept. 23, 2015), <https://fortune.com/2015/09/23/alibaba-says-numbers-real-not-fake/>.

<sup>107</sup> Adam Levy, *The 7 Largest E-Commerce Companies in the World*, THE MOTLEY FOOL (Dec. 26, 2018), <https://www.fool.com/investing/2018/12/26/the-7-largest-e-commerce-companies-in-the-world.aspx>.

From Alibaba's earliest days of operation, back in 1999, MNCs have claimed that counterfeits are abundantly available on Alibaba's websites.<sup>108</sup> Frustrated with the lack of results in China, U.S. companies have raised these concerns with the U.S. government and, as a result, Alibaba has been repeatedly placed on U.S. government blacklists. Despite its many claims that it is implementing new changes to effectively combat counterfeiting on its websites, Alibaba has been placed on the 2014 Out of Cycle Notorious Markets List<sup>109</sup> by the Office of the United States Trade Representative, again on the 2016 Out of Cycle Notorious Markets List,<sup>110</sup> and also on the 2017 Out of Cycle Review of Notorious Markets List.<sup>111</sup> Alibaba had been placed on the Notorious Markets List in 2011<sup>112</sup> and sought to remove itself from the list in anticipation of its initial public offering (IPO) in the United States in 2014. Although Alibaba was dropped from the 2012 list,<sup>113</sup> Alibaba found itself once again on the Notorious Markets list in 2014, 2016, 2017 and 2018. Furthermore, in 2016, a group of 17 international trade associations reiterated their concerns in a letter to USTR, stating:

During the ten months since USTR published [the 2015 USTR Special 301 Notorious Markets Report] we have seen little evidence that there has been any noticeable change on the Alibaba platforms themselves; and at any given moment, a consumer around the world can chose from hundreds of thousands of counterfeit clothes, shoes, travel goods, handbags, toys, auto parts, jewelry, watches, furniture, electronics, pharmaceuticals, and other articles.<sup>114</sup>

Many brand owners have concluded that Alibaba, despite its protestations to the contrary, actually tolerates and supports counterfeiting on its websites because Alibaba earns revenues from all sales, including sales of counterfeit goods. Labelling Alibaba as "our most dangerous and damaging adversary,"<sup>115</sup> one brand owner stated:

<sup>108</sup> See, e.g., *Alibaba and the 2,236 Thieves: An Online-Fraud Scandal in China*, THE ECONOMIST (Feb. 22, 2011), <https://www.economist.com/newsbook/2011/02/22/alibaba-and-the-2236-thieves>;

<sup>109</sup> U.S. TRADE REPRESENTATIVE, 2014 OUT-OF-CYCLE NOTORIOUS MARKETS LIST 8 (Mar. 5, 2015), available at (Taobao). Available at [https://ustr.gov/sites/default/files/2014%20Notorious%20Markets%20List%20-%20Published\\_0.pdf](https://ustr.gov/sites/default/files/2014%20Notorious%20Markets%20List%20-%20Published_0.pdf) (Taobao.com).

<sup>110</sup> U.S. TRADE REPRESENTATIVE, 2016 OUT-OF-CYCLE NOTORIOUS MARKETS LIST 12–13 (Dec. 2016), available at <https://ustr.gov/sites/default/files/2016-Out-of-Cycle-Review-Notorious-Markets.pdf> (Taobao.com).

<sup>111</sup> U.S. TRADE REPRESENTATIVE, 2017 OUT-OF-CYCLE NOTORIOUS MARKETS LIST 20–23 (Jan. 11, 2018), available at <https://ustr.gov/sites/default/files/files/Press/Reports/2017%20Notorious%20Markets%20List%201.11.18.pdf> (Taobao.com).

<sup>112</sup> U.S. TRADE REPRESENTATIVE, OUT OF CYCLE REVIEW OF NOTORIOUS MARKETS 3 (Dec. 20, 2011), available at <https://ustr.gov/sites/default/files/uploads/gsp/speeches/reports/2011/Notorious%20Markets%20List%20FINAL.pdf> (Taobao.com).

<sup>113</sup> Doug Palmer, *U.S. Drops China's Taobao Website from "Notorious" List*, REUTERS (Dec. 13, 2012), <https://www.reuters.com/article/net-us-usa-trade-piracy/u-s-drops-chinas-taobao-website-from-notorious-list-idUSBRE8BC1IG20121213>.

<sup>114</sup> 2016 Special 301 Out-of-Cycle Review of Notorious Markets, Docket Number: USTR-2016-2013, at 2 (Oct. 26, 2016), available at <https://www.mema.org/sites/default/files/resource/Multi-Org%20Letter%20on%20Alibaba%20102616.pdf> (correspondence from AFL-CIO et al. to Probir Mehta, Assistant United States Trade Representative).

<sup>115</sup> Letter from Lee S. Sporn of Michael Kors (USA), Inc. to Bob Barchiesi, President, International Anti-Counterfeit Coalition (IACC), dated April 21, 2016, at 2. See Erika Kinetz, *Some Howl Over*

Alibaba's strategy has consistently been to provide lip service to supporting brand enforcement efforts while doing as little as possible to impede the massive flow of counterfeit merchandise on its platforms [that] continues to flow in staggering volumes.<sup>116</sup>

#### *a. Alibaba's Defense of Counterfeits*

The skepticism of many brand owners' about Alibaba's sincerity in combatting counterfeiting can be attributed to statements made by its Chairman and founder, Jack Ma, that are a defense of counterfeiting. In responding to criticism by luxury brands about the sale of counterfeits on Alibaba, Ma made clear his position in 2015:

The longer Ma talks, the more it's clear where his sentiments fall. The second-richest man in China thinks the very idea of luxury retail—selling belts and accessories and the like for thousands of dollars—is inherently absurd. "How can you sell Gucci or whatever branded bag for so much money? It is ridiculous," he says. "I understand the branded companies are not happy, but I also say that's your business model. You have to check your business model, too."<sup>117</sup>

The following year, in a speech at Alibaba's headquarters, Ma stated:

The problem is the fake products today are of better quality and better price than the real names. They are exactly the [same] factories, exactly the same raw materials but they do not use the names.<sup>118</sup>

These statements suggest that Ma believes that there is a normative justification for Alibaba's support of counterfeits. Ma believes luxury brands like Gucci are inviting unauthorized copies by charging prices so high that they are "absurd." Alibaba sees itself as helping out small-time sellers that sell counterfeits or infringing products and who are able to lift themselves into the middle class. Jack Ma and Alibaba take on a modern "Robin Hood" persona. Just as the fictional Robin Hood robbed from the rich to give to the poor, Alibaba is assisting small-time Chinese sellers to take a free ride on the goodwill of luxury brands owned by MNCs that have invited counterfeiting through their greed, avarice, and attempts to gouge vulnerable Chinese consumers. China's consumers also benefit from having access to fakes that are "of better quality and better price than

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*Alibaba's Place in Anti-Counterfeiting Group*, AP News (May 5, 2016), <https://www.apnews.com/2c9381cb0c2841aba956abef1a3005b3>.

<sup>116</sup> Letter from Lee S. Sporn, *supra* note 115, at 2. See Kathy Chu, *Brands Voice Doubts After Alibaba Joins Group Fighting Fake Goods*, WALL ST. J. (April 28, 2016), <https://www.wsj.com/articles/brands-voice-doubts-after-alibaba-joins-group-fighting-fake-goods-1461763178>.

<sup>117</sup> Michael Schuman, *Why Alibaba's Massive Counterfeit Problem Will Never Be Solved*, FORBES (Nov. 4, 2015), <https://www.forbes.com/sites/michaelschuman/2015/11/04/alibaba-and-the-40000-thieves/#31848fd729dc>.

<sup>118</sup> Charles Clover, *Alibaba's Jack Ma Says Fakes Are Better Than Originals*, FINANCIAL TIMES (June 14, 2016), <https://www.ft.com/content/6700d5cc-3209-11e6-ad39-3fee5ffe5b5b>.

the real names.”<sup>119</sup> Ma’s position may help Alibaba to further gain popularity in China by enhancing Ma’s reputation as a true national hero and great patriot of China, but it also infuriates brand owners.<sup>120</sup>

b. *Counterfeits for Sale on Alibaba*

To test the claims of brand owners that counterfeits are found in abundance on Alibaba’s sites, the author recently did a search of Alibaba sites and immediately found many examples of counterfeits and infringing products. Photographs of the webpages containing three of these examples are set forth in the Appendices. These examples are discussed below, but there are other examples on this site that are too numerous to discuss within the confines of this Article.

(a) Appendix 1 is an advertisement for handbags being sold under a “big brand name” (“Da Pai”) called “Gucci Guccio.” These handbags copy the design and trade dress of Gucci handbags and use the name “Gucci” as part of their brand name.<sup>121</sup> Gucci was singled out by Alibaba Chairman Jack Ma as a luxury brand owner selling its products at absurdly high prices.<sup>122</sup> The advertised price for these products is 1500 Renminbi (“people’s currency” or RMB). At the currency exchange rate of 1 RMB to .15 U.S. dollar, this price is the equivalent of about \$225 dollars. On Gucci’s website in the United States, genuine Gucci bags similar to the ones advertised on Alibaba sell for over \$2,000 dollars with some bags selling for as much as \$7,500.<sup>123</sup> It is highly unlikely for a genuine Gucci handbag of the type in this advertisement to sell for \$225. It is also highly unlikely that these types of prices can be charged for gray market goods.<sup>124</sup> In addition, nothing in the advertisement indicates that these are second hand or used goods. In addition, Chinese consumers have an aversion to purchasing secondhand goods due to cultural reasons, and Chinese merchants are well aware of consumers’ dislike of secondhand goods.<sup>125</sup> It is highly likely that the products advertised in the attached Alibaba webpage are counterfeits.

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<sup>119</sup> *Id.*

<sup>120</sup> See Letter from Lee S. Sporn, *supra* note 115. When Alibaba was accepted as a member of the International Anti-Counterfeiting Coalition, Sporn, who represents Michael Kors, a fashion house, resigned in protest. Chu, *supra* note 116.

<sup>121</sup> The author was told by an associate in China that Alibaba did not consider “Gucci Guccio” to be an infringing or counterfeit use because the name “Gucci” did not appear alone but was accompanied or modified by another name as part of the product’s brand name. Only the unauthorized use of a trademark such as Gucci appears alone would be considered an infringing use.

<sup>122</sup> See *infra* text accompany note 117.

<sup>123</sup> *Women’s Handbags*, GUCCI, <https://www.gucci.com/us/en/ca/women/womens-handbags-c-women-handbags/1> (last visited July 1, 2019).

<sup>124</sup> While prices for gray market goods are usually lower than prices for genuine goods intended for the home market, the price differential would not be as great as that set forth in the case of the handbags in Appendix 1, i.e. it would no highly unlikely that a genuine handbag that sold for approximately \$2,000 to \$7,500 in Japan could be sold as a gray market good in China for \$225.

<sup>125</sup> See Yiling Pan, *Why the Second Hand Luxury Market isn’t Thriving in China*, Jing Daily (Aug. 24, 2017), <https://jingdaily.com/what-blocks-secondhand-luxury-market-thriving-in-china/> (last visited July 12 2019) ( Chinese consumers “still prefer to purchase new luxury goods and look down on the value of second-hand goods”).

(b) Appendix 2 is an advertisement for a 700 ml bottle of Hennessy XO cognac with an advertised price of 432 RMB or \$65. A similarly sized bottle (750 ml) sells for approximately \$160 in the United States.<sup>126</sup> It is highly likely that the bottle sold on the Alibaba website is a counterfeit.

(c) Appendix 3 is an advertisement for fashion workout pants made by Abercrombie and Fitch, based in Columbus, Ohio, selling at a price of 80 RMB or \$12. Based on the photograph and the author's experience in tracking counterfeiters in the consumer products industry, it is apparent that these products are of a low quality and are inferior to what Abercrombie and Fitch would sell in retail stores. By comparison, Appendix 4 includes a photograph of a similar Abercrombie and Fitch product from its website that sells for \$58.<sup>127</sup> These facts indicate that it is highly likely that the product advertised on the Alibaba website is a counterfeit.

To understand why brand owners view examples such as these as threats to their business, it is necessary to realize that in China (as in many other countries) there is a huge appetite for counterfeit goods, and many consumers actively search for and buy counterfeits.<sup>128</sup> The vast majority of consumers in China who visit the webpages for the products described in the examples above are fully aware that these are counterfeit goods, but these consumers are actively seeking these goods.<sup>129</sup> In the case of counterfeit Gucci handbags and counterfeits of other famous brand names, consumers are actively seeking to buy cheap imitations of the famous brand that they can purchase for a tenth or less than the genuine product.<sup>130</sup> These consumers want the prestige of the brand, trademark, or trade dress and are not concerned about the quality of the actual merchandise itself.<sup>131</sup> So long as the product has the trademark or trade dress, the purchaser of the counterfeit is able to enjoy the good will associated with the brand name or trademark.<sup>132</sup> In China today (as in many other countries), there is an enormous demand for counterfeit luxury branded handbags that offer the prestige of the genuine brand at a fraction of the price of the genuine product.<sup>133</sup>

The same is true with counterfeit liquor as shown in example (b) above. Consumers in China who purchase counterfeit bottles of famous brand name liquor are not in general buying the

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<sup>126</sup> *Hennessy Cognac XO*, WINE CHATEAU, <https://www.winechateau.com/products/hennessy-cognac-xo> (last visited July 1, 2019).

<sup>127</sup> See Appendix 4 *infra*.

<sup>128</sup> China is the source of many counterfeit luxury handbags. In a recent raid, the U.S. seized fake luxury handbags and other goods worth half a billion dollars and enough to fill 22 shipping containers. See

<sup>129</sup> This observation is based on the author's own experience in China. See Liz Robbins, Investigators Seize Fake Luxury Goods, NY Times (Aug. 16, 2018), <https://www.nytimes.com/2018/08/16/nyregion/fake-luxury-goods-handbags.html>.

<sup>130</sup> This observation is based on the author's work with private investigation companies tracking counterfeiters in China.

<sup>131</sup> See DANIEL C.K. CHOW AND EDWARD LEE, INTERNATIONAL INTELLECTUAL PROPERTY: PROBLEMS, CASES, AND MATERIALS 784 (3d ed. 2017) (consumers will knowingly purchase fake luxury goods).

<sup>132</sup> Id.

<sup>133</sup> Id.

liquor for private or personal consumption.<sup>134</sup> In China, for personal or professional reasons, people often have banquets or dinners where highly alcoholic drinks are served and consumed in large quantities as part of social drinking rituals.<sup>135</sup> It is a mark of prestige for a host to serve a famous foreign brand of liquor, such as a French made cognac like Hennessy or a Western brand of whiskey such as Johnny Walker Black Label.<sup>136</sup> There is a huge demand for this type of counterfeit liquor, where the counterfeiter uses a bottle that is either a copy or a genuine used bottle and fills it with a cheap but potent liquor.<sup>137</sup> The host can enjoy the good will of serving his guests a high prestige brand while only paying for a common liquor that, while inexpensive, is just as potent but is not contaminated or harmful to the guests.

In the case of (c), young adults in China are highly fashion conscious and are hungry for famous international brands.<sup>138</sup> Most consumers viewing the webpage with Abercrombie and Fitch pants selling for \$12 are fully aware that these are counterfeits and that the product is of a low quality. They reason, however, that they can pay about the same price for a low quality product without the prestige of the counterfeit Abercrombie label or pay a little bit more for the same product but enjoy the prestige of the Abercrombie brand name. Many consumers will chose the latter alternative.<sup>139</sup>

## *2. Alibaba's "Arrogance" and Illegal Activities*

While MNCs have consistently complained about Alibaba's tacit approval and support of counterfeiting, these sentiments were recently confirmed for the first time by enforcement authorities in China in connection with an extraordinary national level investigation of Alibaba. The State Administration of Industry and Commerce (SAIC) and its local branches (AICs) are charged with maintaining orderly markets in the PRC and are primarily responsible to stem the flow of counterfeit goods.<sup>140</sup> In the case of Alibaba, the SAIC took the unprecedented step of conducting an administrative guidance meeting with Alibaba officials in July 2014.<sup>141</sup> The Director

<sup>134</sup> These observations about the use of alcohol in China are based upon the author's own experience and based on discussions with colleagues and associates.

<sup>135</sup> See Nathan H. Gray, "*Gan Bei*": *Business and Ritualistic Drinking in China* (Apr. 22, 2010), <https://nathanhgray.wordpress.com/2010/04/22/gan-bei-business-and-ritualistic-drinking-in-china/> (discussing the importance of drinking rituals).

<sup>136</sup> See Jiani Ma, *Rich Post-80s Drive Chinese Whiskey Market Growth* (Apr. 16, 2018), <https://jingdaily.com/chinese-whiskey-market/> (noting the demand for premium and super premium brands of whiskey and cognac in China).

<sup>137</sup> Natalie Wang, *Nearly 40% of Chinese Consumers Admit to Purchasing Fake Booze* (Mar. 19, 2018), <https://www.thedrinksbusiness.com/2018/03/nearly-40-chinese-consumers-admit-to-purchasing-fake-booze/> (noting that consumers admit to intentionally purchase fake booze in China).

<sup>138</sup> See, e.g., *Luxury Brands Tailor their Marketing to Asian Millennial Consumers*, THE FASHION LAW (Aug. 7, 2018), <http://www.thefashionlaw.com/home/luxury-brands-tailor-their-marketing-to-millennial-consumers-in-the-far-east>.

<sup>139</sup> This observation is based upon the authors' experience in investigating counterfeit consumer products in China.

<sup>140</sup> *State Administration of Industry and Commerce*, IP CHANNEL (Feb. 9, 2010), <http://ip.people.com.cn/GB/152255/10960401.html>.

<sup>141</sup> See Transcript of Administrative Guidance Meeting Between SAIC and Alibaba, held July 14, 2016 (on file with author) [hereinafter Transcript of Admin. Guidance Meeting]; Huang, *supra* note 31 ("On July 16, 2014, the administrative guidance group of the Internet Supervision Department . . . held an

of the SAIC emphasized the unique nature of the meeting when he stated, “For this meeting, I didn’t know whether it’s the first ever of its kind, or the last, but I hope that this would be the last time for a meeting of this nature.”<sup>142</sup>

Enforcement actions are usually the provenance of local AICs as the SAIC, the central level authority, is a supervisory and policy-making body.<sup>143</sup> However, the SAIC believed that in the case of Alibaba, it was necessary for it to step in to resolve a case that had proven to be intractable to local authorities.<sup>144</sup> In the administrative guidance meeting, the SAIC and appropriate local level AICs met with Alibaba officials in order to set forth an agreed upon set of steps to remediate counterfeiting on Alibaba platforms.<sup>145</sup>

The administrative guidance meeting between the SAIC and Alibaba executives occurred on July 16, 2014,<sup>146</sup> and on January 28, 2015, the SAIC issued a White Paper to summarize as a follow up to the meeting and to formally set forth a plan of remediation.<sup>147</sup> In both the transcript of the meeting and in the SAIC White Paper, the SAIC makes the point repeatedly that at the time of the meeting in July 2014 there were numerous counterfeits, infringing products, and other violations of Chinese laws on advertising, product information, and licensing on Alibaba’s websites.<sup>148</sup>

However, the point being made by the SAIC White Paper and during the administrative guidance meeting is more subtle, and even more deep-seated, than the need to control persistent illegal activities. For example, the SAIC states:

Alibaba Group, for a long time, *has failed to take seriously* the operational violations on its e-commerce platforms and did not take effective measures to address the violations. This caused a minuscule issue to snowball into a serious problem, leading Alibaba to its greatest crisis since its incorporation.<sup>149</sup>

This critique is not directed at practices involving IP rights; it is directed at an underlying culture at Alibaba, which is one of viewing itself as above the law, including an attitude of a willful refusal to obey the law. At another point, the SAIC White Paper states:

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administrative guidance forum at the Zhejiang Province Industry and Commerce Bureau. Principal officers and management teams of the core departments of Alibaba Group attended the meeting and accepted administrative guidance.”). See also Heather Timmons, *Chinese Regulators Flagged Illegal Practices at Alibaba Months Before Its Monster IPO*, QUARTZ (Jan. 28, 2015), <https://qz.com/334863/chinese-regulators-flagged-illegal-practices-at-alibaba-months-before-its-monster-ipo/>. Administrative guidance is governed by the SAIC’s Comprehensive Promotion of Administrative Guidance Work (2009).

<sup>142</sup> Transcript of Admin. Guidance Meeting, *supra* note 141, at 128.

<sup>143</sup> *State Administration of Industry and Commerce*, *supra* note 141 (“The [SAIC] . . . is the competent authority of ministerial level directly under the State Council in charge of market supervision/regulation and related law enforcement through administrative means.”).

<sup>144</sup> See SAIC WHITE PAPER, *supra* note 31, at 11–12.

<sup>145</sup> The steps were later summarized in the SAIC White Paper, *id.*

<sup>146</sup> See *id.*; Huang, *supra* note 31.

<sup>147</sup> See SAIC WHITE PAPER, *supra* note 31. The purpose of the White Paper is to provide “various understandings and information about the said administrative guidance meeting” to Alibaba. See *id.* at 11.

<sup>148</sup> Transcript of Admin. Guidance Meeting, *supra* note 135, at 3–8.

<sup>149</sup> SAIC WHITE PAPER, *supra* note 31, at 11–12 (emphasis added).

It is suspected that [Alibaba] knowingly, intentionally, by negligence or in spite of their presumed knowledge facilitates unlicensed operations, trademark infringements, untruthful publicity, pyramid schemes and violations of consumers' rights.<sup>150</sup>

The SAIC traces Alibaba's flouting of the law to an attitude of "arrogance."<sup>151</sup> An AIC official at the July 16, 2014 meeting stated that when speaking to Alibaba employees, he felt "a kind of arrogant emotion sprouting and growing."<sup>152</sup> In its White Paper, the SAIC specifically tells Alibaba that it should "redress arrogance."<sup>153</sup> The SAIC informs Alibaba that it cannot expect to "receive special treatment under law. . . . Regulators . . . shall treat businesses equally under law."<sup>154</sup> The SAIC admonishes Alibaba to "ethically conduct business. An enterprise shall not get what it wants at its own will."<sup>155</sup> At the administrative guidance meeting, the SAIC warned Alibaba that it cannot flout the law when it finds the law interferes with its interests and then assert the law when it needs the law's protection despite acting without credibility or integrity.<sup>156</sup>

Although the SAIC stood in the position of a law enforcer at the meeting, the SAIC at times seemed to descend into the role of a sycophant flattering the Alibaba executives for the purpose of cajoling and pleading with them to respect the law. For example, at the administrative guidance meeting, AIC officials lavishly praised Alibaba, telling the executives how proud the PRC was of their accomplishment,<sup>157</sup> mentioning that all of the Alibaba executives at the meeting were "famous people"<sup>158</sup> and "big shots,"<sup>159</sup> and joking that the monthly salary of just one of the Alibaba executives were as much as the combined annual salaries of all the AIC officials present at the meeting.<sup>160</sup>

#### a. Specific Practices

Alibaba's lack of respect for the law is manifested in two practices that drew the SAIC's special attention and were the focus of discussion during the administrative guidance meeting. The SAIC states that "a large number of Alibaba staffers take business bribes" in exchange for giving platform participants preferential business opportunities to squeeze out their competitors.<sup>161</sup> While Alibaba was already aware of the bribery problem and took some steps to control it, the AICs

<sup>150</sup> *Id.* at 14.

<sup>151</sup> *Id.* at 20.

<sup>152</sup> Transcript of Admin. Guidance Meeting, *supra* note 141, at 117.

<sup>153</sup> SAIC WHITE PAPER, *supra* note 31 at 20.

<sup>154</sup> "No market player shall receive special treatment under law. The management of Alibaba family shall understand their bottom line. Regulators in the applicable jurisdiction shall treat businesses equally under law." *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> "An enterprise shall not get what it wants at its own will, i.e. when needing credibility to protect an enterprise's interest, it boasts about credibility but throws the law away; when needing law to protect itself, it raises up high the flag of law but intentionally ignores its duties regarding credibility and integrity." *Id.*

<sup>157</sup> Transcript of Admin. Guidance Meeting, *supra* note 141, at 13.

<sup>158</sup> *Id.* at 39.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 109.

<sup>161</sup> SAIC WHITE PAPER, *supra* note 31, at 16.

stated that bribery was still a problem as of the July 16, 2014 administrative guidance meeting,<sup>162</sup> and an Alibaba vice president at the meeting acknowledged that “temptation from the outside” is a problem among the Alibaba staff.<sup>163</sup> The SAIC also cited Alibaba employees’ active participation in misleading consumers and committing various consumer protection violations. For example, the SAIC notes that “[s]ome of the online shops, through the trading with others, delete negative comments, providing business information to themselves and others that disrupts normal business order. . . . But your supervision and punishment are not strict enough. There are staff in your company involved in this violation.”<sup>164</sup> A second set of practices involves Alibaba employees working together with counterfeiters, tipping the counterfeiters off to enforcement actions. For example, an SAIC official stated that in once instance the SAIC asked Alibaba for information about ten online stores suspected of selling counterfeits, and although Alibaba provided the information, seven of the stores promptly closed, two cancelled their accounts, and one started to sell authentic products.<sup>165</sup> The SAIC concluded that “[t]his indicated information disclosure by your company staff”,<sup>166</sup> to the counterfeiters. In another instance, the SAIC stated that after local AICs provided Taobao, an Alibaba affiliate e-commerce site, with information about their investigations, Taobao was suspected of tipping off counterfeiters and manufacturers of illegal narcotics.<sup>167</sup>

The unlawful activities by Alibaba employees discussed at the administrative guidance meeting in July 2014 came just three years after a major scandal in 2011 that involved about 100 Alibaba employees, including supervisors and sales managers, who after an internal investigation were found to be directly responsible for allowing over 2,300 China Gold Suppliers to defraud international buyers.<sup>168</sup> Long time CEO David Wei Zhe and COO Elvis Lee Shi Huei were forced to resign as a result of the scandal.<sup>169</sup> According to news reports, Alibaba lost \$933 million in market share due to the scandal.<sup>170</sup> Three years after this scandal, according to the SAIC, numerous

<sup>162</sup> Transcript of Admin. Guidance Meeting, *supra* note 141, at 9 (“The sixth problem is what was included in governance, that is, the commercial bribery existing among the staff of Taobao.com. Suppliers and users of the platform are all involved. You have realized this problem and tried to keep it under control. However, the situation still exists.”).

<sup>163</sup> Alibaba executive Xiaofeng Shao: “Recently, we have continued to improve the punishment system, even including the standards for our internal staff because this is also a big problem we face like the temptation from the outside.” *Id.* at 92.

<sup>164</sup> *Id.* at 10.

<sup>165</sup> *Id.* at 11.

<sup>166</sup> *Id.*

<sup>167</sup> SAIC WHITE PAPER, *supra* note 31, at 17.

<sup>168</sup> Pascal-Emmanuel Gobry, *Huge Fraud at China E-Commerce Giant Alibaba.com: Management Out, 100+ Employees Dismissed*, Bus. Insider (Feb. 21, 2011), <https://www.businessinsider.com/alibaba-ceo-resigns-over-huge-fraud-scandal-2011-2>; Kelvin Soh, *Alibaba.com CEO Resigns After Jump in Fraudulent Sales*, REUTERS (Feb. 21, 2011), <https://www.reuters.com/article/us-alibaba/alibaba-com-ceo-resigns-after-jump-in-fraudulent-sales-idUSTRE71K1QA20110221> (“Members of our company’s senior management knew of a noticeable increase of fraud claims by global players against China Gold Supplier customers on the international marketplace that began in late 2009,’ Ma said in the statement.”).

<sup>169</sup> Gobry, *supra* note 168; Soh, *supra* note 168.

<sup>170</sup> Mark Lee, *Alibaba Shares Tumble After Fraud Leads to CEO Departure*, BLOOMBERG (Feb. 22, 2011), <https://www.bloomberg.com/news/articles/2011-02-22/alibaba-com-downgraded-by-morgan-stanley-after-ceo-wei-resigns>.

members of Alibaba's staff continued to conduct illegal activities adding further to its perception of a culture of lawlessness at Alibaba.

#### b. *Above the Law in China*

Alibaba's "arrogance" needs to be understood in the context of China's legal and political culture. In China today, it is not unusual for powerful entities to routinely disregard the law. In general, the more powerful an entity, the less compelled it feels to follow the law, and Alibaba is among a handful of the most powerful entities in China. As a mundane example familiar to every citizen in China, cars registered to the People's Liberation Army ("PLA") do not obey traffic laws.<sup>171</sup> Every car registered to the PLA has a special license plate. These cars will routinely drive through red lights, speed, and refuse to pay tolls. Under China's current security systems, cars that drive through red lights are recorded by cameras stationed at every traffic stop, and letters containing fines are sent to transgressors. PLA cars, however, do not pay fines. No regular police officer with the Public Security Bureau will dare to stop a PLA car for a traffic violation, and no toll collector will dare to challenge a PLA car that refuses to pay the toll. This is a deeply embedded cultural attitude that starts at the top with the most powerful entity of all in Chinese society: the Communist Party, which views itself as above the law and views the law as a mere instrument for it to use to achieve its own ends.<sup>172</sup> These Party attitudes will be familiar to Jack Ma, the chairman of Alibaba, who is also a member of the Communist Party,<sup>173</sup> as are other senior Alibaba executives.<sup>174</sup>

As noted earlier, Alibaba's size is prodigious, and its financial power overwhelming.<sup>175</sup> In China today, an entity that is as large and powerful as Alibaba does not believe that it needs to answer to lowly government enforcement officials. Alibaba executives, such as Chairman Jack Ma, himself a Communist Party member, and other senior Alibaba officials who are also Party members, believe that they do not answer to the law but only to the Party, the ultimate authority in China.<sup>176</sup> One example of the close link between Alibaba and the Party is that Alibaba runs China's new social credit system.<sup>177</sup> Alibaba assigns a three digit score (from 350 to 950) to each citizen in China based on the social desirability of the citizen's conduct, allowing China to punish or reward its citizens.<sup>178</sup> These close ties further suggest that Alibaba is not intimidated by and does not fear PRC enforcement authorities. For their part, PRC enforcement authorities are reluctant to shut down or seriously harm Alibaba because such actions will lead to significant

<sup>171</sup> The author has witnessed these practices by the PLA firsthand in China.

<sup>172</sup> DANIEL C.K. CHOW, THE LEGAL SYSTEM OF CHINA IN A NUTSHELL 62 (3d ed. 2015): "[N]either Imperial China nor pre-reform modern China recognized or accept the rule of law . . . [T]he Communist Party views itself as holding unchallenged authority. In modern China, the Communist Party is supreme."

<sup>173</sup> Li Yuan, *Jack Ma, China's Richest Man Belongs to the Communist Party. Of Course.*, N.Y. TIMES (Nov. 27, 2018), <https://www.nytimes.com/2018/11/27/business/jack-ma-communist-party-alibaba.html>.

<sup>174</sup> The author has personal knowledge that senior Alibaba officials are Party members from his current work as a legal expert in litigation involving China.

<sup>175</sup> See *supra* text accompanying notes 103–107.

<sup>176</sup> This observation is based upon the author's own assessment and analysis.

<sup>177</sup> Campbell, *supra* note 42.

<sup>178</sup> *Id.*

financial losses for China and the possible demise of one of the world's leading technology companies and a great source of national pride.<sup>179</sup>

An indication of how Alibaba continues to view itself as above the law in China is that on April 25, 2019, the USTR placed Alibaba on its Notorious Markets List for the third year in a row.<sup>180</sup> This designation occurs five years after the SAIC administrative guidance meeting in July 2014 and four years after the SAIC issued the White Paper detailing a plan of remediation in 2015. In its 2019 report, the USTR stated, "Although Alibaba has taken some steps to curb the offer and sale of infringing products, right holders . . . continue to report high volumes of infringing products and problems with using takedown procedures."<sup>181</sup> After a history of misconduct and scandal, vehement protests by brand owners, an extraordinary effort by the PRC government, and numerous blacklists by the U.S. government, Alibaba's conduct has not changed appreciably. Under these circumstances, brand owners must confront the reality that Alibaba is not likely to change its conduct without intervention by the highest levels of the Party, probably only by a personal decision by Xi Jinping, China's President and the General Secretary of the Communist Party.<sup>182</sup> Until senior Party leaders intervene, brand owners must accept the likelihood that Alibaba believes that it can operate outside of the law in China with impunity and without fear of government reprisals.

#### E. Amazon

Amazon is currently the largest e-commerce marketplace in the United States<sup>183</sup> and is second largest in the world, trailing only Alibaba.<sup>184</sup> As of 2016, the market value of Amazon exceeded that of the 8 largest U.S. brick and mortar retailers, including Walmart, Target, and Best Buy, put together.<sup>185</sup> In December 2018, Amazon's GMV reached \$239 billion.<sup>186</sup> One of its most popular online retail services, Amazon Prime, now has over 100 million members worldwide.<sup>187</sup> Amazon's official anti-counterfeiting policy states that it is the responsibility of the seller or supplier to ensure that its products are genuine, not counterfeits.<sup>188</sup> Two aspects of Amazon's business practices have led to a rise in online counterfeits.

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<sup>179</sup> This observation is based upon the author's assessment of the overall tone of the SAIC White Paper, *supra* note 31, and the transcript of the administration guidance meeting, *supra* note 141.

<sup>180</sup> OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, OUT OF CYCLE REVIEW OF NOTORIOUS MARKETS 27, [https://ustr.gov/sites/default/files/2018\\_Notorious\\_Markets\\_List.pdf](https://ustr.gov/sites/default/files/2018_Notorious_Markets_List.pdf).

<sup>181</sup> *Id.*

<sup>182</sup> This is the author's professional opinion based on his experience and knowledge of China. Xi's positions, see *President Xi Jinping*, USCBC, <https://www.uschina.org/president-xi-jinping> (last visited July 1, 2019). See also #1 *Xi Jinping*, FORBES, <https://www.forbes.com/profile/xi-jinping/#2f2f40051601> (last visited July 1, 2019) (President Xi became the "core" leader of the Communist Party in 2016.).

<sup>183</sup> See Levy, *supra* note 107.

<sup>184</sup> *See id.*

<sup>185</sup> Jeff Desjardins, *The Extraordinary Size of Amazon in One Chart*, VISUAL CAPITALIST (Dec. 30, 2016), <https://www.visualcapitalist.com/extraordinary-size-amazon-one-chart/>.

<sup>186</sup> See Levy, *supra* note 107.

<sup>187</sup> Austen Hufford & Georgia Wells, *Amazon Prime Has More Than 100 Million Members*, WALL ST. J. (Apr. 18, 2018), <https://www.wsj.com/articles/amazon-prime-has-more-than-100-million-members-1524088630>.

<sup>188</sup> *Amazon Anti-Counterfeiting Policy*, AMAZON, <https://sellercentral.amazon.com/gp/help/external/201165970> (last visited July 1, 2019).

Once a brand owner agrees to sell its products on Amazon's e-commerce marketplace, Amazon will source products not only from the brand owner, but also from other third-party vendors that sell the branded products. In order to have sufficient inventory on hand to satisfy customer orders expeditiously, Amazon's warehouses will co-mingle products from the brand owner and from other third-party vendors into a single source of supply.<sup>189</sup> If a third-party vendor ships a counterfeit product to Amazon, it becomes co-mingled with genuine products in Amazon's warehouse. When a customer orders a product online, the customer may receive a product from the warehouse from either the brand owner or a third-party vendor, which might be a counterfeit. The source of the product is not clear to the customer when he or she makes a purchase, but the customer will generally assume that it was manufactured by the brand owner.

Unable to make inroads into China's e-commerce marketplace against competitors such as Alibaba, Amazon decided in 2015 to woo Chinese manufacturers to sell directly to U.S. consumers on its e-commerce site.<sup>190</sup> As China is the world's largest source of counterfeits, the result was predictable: beginning in 2015, counterfeits soon began to proliferate on Amazon's e-commerce sites, much to the chagrin and exasperation of brand owners. Brand owners' complaints against Amazon also echo some of the complaints against Alibaba. For example, according to one brand owner representative, "Amazon is making money hand over fist from counterfeiters, and they've done about as little as possible for as long as possible to address the issue."<sup>191</sup>

### III. ENTITY VERIFICATION MEASURES AND THE REQUIREMENTS OF PRC LAW

The discussion in Part II centers on how, although brand owners voice similar concerns about counterfeits available on Alibaba and Amazon, the concern is different in each case. The major complaint by brand owners with Alibaba is that it facilitates the sale of counterfeits in order to satiate the enormous appetite for counterfeits among China's consumers. In the case of Amazon, the major concern of brand owners is that U.S. consumers who seek to purchase genuine products are instead deceived into purchasing a counterfeit. In both cases, brand owners have expressed frustration with the lack of effective enforcement by these Internet platforms against webpages or postings selling counterfeits on their websites. These problems are further discussed below.

#### A. *Problems with Enforcement*

Although brand owners have many numerous complaints about enforcement issues against counterfeiters on Alibaba and Amazon platforms, the crux of these complaints can be summarized as follows: (1) counterfeiters use false identities and addresses and are untraceable; (2) brand owners must suffer through the use of cumbersome and ineffective notice and takedown procedures; and (3) existing measures used by Internet platforms do not create deterrence of repeat infringing activity.

##### 1. *False Names, Identities, and Addresses*

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<sup>189</sup> Pierson, *supra* note 13.

<sup>190</sup> Shepard, *supra* note 9.

<sup>191</sup> Levy, *supra* note 18.

Current e-commerce platforms, including Alibaba and Amazon, do not subject new sellers to adequate verification or confirmation although Alibaba is required to do so under PRC law; without an enforced verification or confirmation process, counterfeiters routinely use false or inaccurate names and addresses when registering with these Internet platforms.<sup>192</sup> When brand owners pursue counterfeiters in enforcement actions, they discover that names and addresses are fictional, and the counterfeiters then disappear into the vast expanse of cyberspace. Brand owners argue that Alibaba and Amazon have few requirements for registration and that verification of this information is not thorough or adequate. In the case of Alibaba, the SAIC White Paper stated that “only lip service is paid to credential review and registration of vendors.”<sup>193</sup> Brand owners often complain that vendors on Amazon use fictitious names and addresses.<sup>194</sup>

## *2. Burdensome Notice and Takedown Procedures*

Internet commerce platforms create bureaucratic or technical hurdles in helping brand owners to locate or identify sources of counterfeits and counterfeiters.<sup>195</sup> These hurdles delay, frustrate, and create additional financial burdens for brand owners.<sup>196</sup> Both Amazon and Alibaba use a notice and takedown procedure that is based upon requirements set forth in the Digital Millennium Copyright Act<sup>197</sup> and similar provisions in PRC law, respectively.<sup>198</sup> When a brand owner discovers an offending webpage or posting, the brand owner is required to submit notices to the Internet service provider under a certain set of criteria that results in the Internet service provider requiring the removal of an offending webpage or posting. Brand owners have described the experience of using notice and takedown procedures as “Kafka-esque”<sup>199</sup> and likened their use to being imprisoned in “Amazon purgatory.”<sup>200</sup> Brand owners are required to place an order for the counterfeit goods, buy and receive the goods from the offending website, test the goods, verify that they are counterfeit, and then submit both the counterfeit and genuine product with notices documenting these actions.<sup>201</sup> Alibaba has a “three strikes” policy,<sup>202</sup> requiring proof of three completed transactions involving counterfeits and submission of notices before an offending webpage can be removed. This process can take months, is expensive, and consumes significant time and effort by the brand owner. Even when brand owners satisfy this arduous process, they complain that the notices are still often ultimately rejected for technical reasons.<sup>203</sup>

## *3. Lack of Deterrence*

<sup>192</sup> SAIC WHITE PAPER, *supra* note 31, at 13.

<sup>193</sup> *Id.*

<sup>194</sup> See *supra* note 97.

<sup>195</sup> See *supra* text accompanying notes 15 & 101.

<sup>196</sup> See Bercovici, *supra* note 15.

<sup>197</sup> See 17 U.S.C. § 512 (2012). See also *Intellectual Property Policy for Sellers*, *supra* note 101 (Amazon); *Intellectual Property Rights (IPR) Protection Policy*, *supra* note 101 (Alibaba).

<sup>198</sup> See generally Trademark Law of the People’s Republic of China, *supra* note 97; Law Against Unfair Competition of the People’s Republic of China, *supra* note 97.

<sup>199</sup> Bercovici, *supra* note 15.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> *Enforcement Actions for Intellectual Property Rights Infringements Claims on Alibaba.com*, Alibaba (Nov. 1, 2017), <https://rule.alibaba.com/rule/detail/2043.htm>.

<sup>203</sup> See Bercovici, *supra* note 15.

In those instances in which brand owners can achieve a takedown of the offending website or otherwise bring pressure to bear on counterfeiters, brand owners complain that once the counterfeit goods disappear, they reappear in short order on a new webpage.<sup>204</sup> Some brand owners refer to this process as a futile game of “Whac-A-Mole” in which a counterfeiter disappears only to immediately reemerge under a new name, identity, and location to resume its counterfeiting operations.<sup>205</sup> In the meanwhile, brand owners have expended significant time, effort, and money in pursuing the counterfeiting without achieving any tangible results.

## B. Proposed Remedial Measures

While counterfeiting on the Internet is a daunting problem, China provides the information technology tools that can be used to deter counterfeiters and that can address each of the three major enforcement issues faced by brand owners: false identities and addresses, convoluted notice and takedown procedures, and rampant recidivism. Most brand owners are completely unaware of or otherwise do not understand these potent tools.

### 1. AIC Business License

As part of China’s extensive system of industrial and social control, a legal regime of identification and attribution of legal liability exists that can be used against counterfeiters involved in Internet commerce. Both in the July 16, 2014 administrative guidance meeting and in its White Paper, the SAIC repeatedly refers to Alibaba’s need to control counterfeiting at the point of entry (i.e., registration on the Alibaba websites). The AICs stressed that if entry is well controlled, many of Alibaba’s current problems can be solved.<sup>206</sup> This Article argues that brand owners should heed the advice of China’s enforcement authorities and seek to have Internet platforms implement effective registration procedures in accordance with the specific requirements of PRC law. These measures can create prophylactic measures at the point of entry that can create an effective deterrent to counterfeiting.

Article 23 of SAIC Order No. 60, Measures on the Administration of Online Transactions (“MAOT”)<sup>207</sup> requires business operators of online platforms to verify the legal identities of all entities or persons applying for access to their platform for the sale of products:

The business operator of a third-party transaction platform shall examine and register as business operators the identities of the legal persons, other economic organizations or industrial and commercial sole proprietors that apply for access to the said platform for sale of products or provision of services, establish registration files and conduct regular verification and updating, and *make public the information specified in their business*

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<sup>204</sup> See *supra* text accompanying note 15.

<sup>205</sup> Bercovici, *supra* note 15.

<sup>206</sup> Hua Yu of Fujian Provincial AIC: “Until now, it seems that there are some difficulties in solving some problems. But in fact, if the entity is well controlled, I don’t think it will be a problem.” Transcript of Admin. Guidance Meeting, *supra* note 135, at 27.

<sup>207</sup> See Administrative Measures for Online Trading, *supra* note 48.

*licenses or provide electronic links to their business licenses in eye-catching locations on its main web pages for business activities.*<sup>208</sup>

As set forth above, Article 23 requires the Internet platform to display information in the business licenses of Internet operators or to provide a link to their business licenses.<sup>209</sup> Under PRC law, every lawful business entity in the PRC must have a business license issued by the local AICs that contains the lawful business scope of the entity, its address, and the name of its legal representative.<sup>210</sup> All lawful enterprises must have an official, AIC-issued business license; any entity that does not have a business license cannot lawfully operate.<sup>211</sup>

Business operators obtain a business license by applying to local AICs that review their proposed business operations to ascertain that they are lawful and economically feasible.<sup>212</sup> For example, if a business operator proposes to sell trademarked products, the AICs will ask for proof of a trademark registration or trademark licensing agreement.<sup>213</sup> The issuance of a business license means that the AICs have reviewed and approved the proposed business plan of the applicant and found it to be lawful.

Among its other functions, the business license sets forth the lawful business scope of the entity. For example, a business license might state that the entity is lawfully authorized to engage in the sale of laundry detergent or other cleansing agents for laundry. Such an entity would be acting unlawfully if it engaged in any business outside of that scope, such as, for example, the sale of peripheral equipment for computers or mobile phones. A business operator that obtains a business license for the sale of genuine products but instead sells counterfeits is in violation of its license and faces a fine or suspension of the license, which would require ceasing business operations.

The business license also prevents the business operator from using a business name and address on an e-commerce site different from that on the business license. Only the business identified in the license by its name and address is lawfully entitled to use the business license, i.e.

<sup>208</sup> *Id.* at art. 23 (emphasis added).

<sup>209</sup> *Id.*

<sup>210</sup> “The business license for a company shall state therein such matters as the name, domicile, registered capital, actual paid-up capital, business scope, the name of the legal representative, etc.” Companies Law of the People’s Republic of China, ch. I, art. 7 (promulgated by the President of the PRC, Order No. 42, Oct. 27, 2005, revised Jan. 1, 2006) [hereinafter Companies Law of the PRC].

<sup>211</sup> Companies Law of the PRC, art. 7 (“Company registration authorities shall issue business licenses for companies established under the law. The date of issuance of a business license for a company shall be the date of establishment of the company.”). See *National Enterprise Credit Information Publicity System*, SAIC, <http://www.gsxt.gov.cn/index.html> (last visited July 1, 2019). See also *The 5-in-1 China Business License (WFOE/WOFE)*, FDI CHINA (July 11, 2018), <https://www.fdichina.com/blog/china-company-registration/wfoe-wofe/5-in-1-business-license/>.

<sup>212</sup> This observation is based upon the author’s own experience in applying for business licenses in China. See Matt Slater, *What Is a China AIC?*, China Checkup (Dec. 9, 2013), <https://www.chinacheckup.com/blogs/articles/china-aic> (“China AICs . . . provide official registration records for all companies in their jurisdiction[.]”).

<sup>213</sup> The author has applied for business licenses in China and was asked by the AIC to provide proof of ownership or authorized use of trademark rights for products sold under the mark to ensure that the business had the legal right to sell the branded products.

such licenses are not transferable and cannot be used by an entity other than the one that applied for and received the business license. A business operator that has sold counterfeit goods and that has been the subject of an enforcement action cannot just simply disappear and reappear on the Internet under a different business name and address; if the name and address do not match that on the license, the use of the license is unlawful. Strictly verifying the information on the business license will prevent business operators accused of counterfeiting from disappearing and immediately reappearing under a different name and address. To use a different name and address, the business operator would have to apply for a new business license from the AIC, a process that could take months.<sup>214</sup>

Requiring a valid business license will preclude many underground counterfeiting factories, petty criminal organizations, smugglers, and other illegal entities from registering to sell on an Internet platform because such entities are unwilling to undergo scrutiny by the AICs for fear that their illegal activities will be exposed, leading to prosecution by AICs and other PRC authorities, such as the Public Security Bureau (the police). These types of nefarious entities and persons are also involved in brick and mortar counterfeiting; they operate illegal underground factories and have no business licenses.<sup>215</sup> However, without a valid business license, these entities will be unable to register on an Internet platform such as Alibaba in accordance with Article 23 of the MAOT.

## *2. Legal Representative*

The business license will also contain the name of the business entity's legal representative.<sup>216</sup> Under PRC law, every lawful business must have a natural person who serves as the legal representative of the business entity.<sup>217</sup> According to PRC law, the legal representative has the clear authority to act on behalf of the business entity and can bind the business entity to contracts and other legal relationships.<sup>218</sup> In many cases, the chairman of the board of directors of a company or a person of a similar rank in other organizations will serve as the legal representative.<sup>219</sup> PRC authorities wanted to make sure that under the law, it was always clear which person within a business enterprise could sign a legally binding contract or create other legal relationships.<sup>220</sup> Although not specifically required by the MAOT, Internet sites should require the business entity's legal representative to undergo the registration procedures so as to make certain that the business entity has lawfully committed to legal obligations created by registration.

Under PRC law, the legal representative is also personally subject to administrative and criminal liability whenever the company conducts illegal operations beyond the range approved

<sup>214</sup> This observation is based on the author's own personal experience in applying for business licenses in China.

<sup>215</sup> The author's own experience is that many of these counterfeiters are petty criminals.

<sup>216</sup> Companies Law of the People's Republic of China, *supra* note 210, at ch. I, art. 7

<sup>217</sup> Companies Law of the PRC, *supra* note 210, at ch. III, art. 38 ("In accordance with the law or the articles of association of the legal person, the responsible person who acts on behalf of the legal person in exercising its functions and powers shall be its legal representative.").

<sup>218</sup> *Id.*

<sup>219</sup> Any person can serve as a legal representative, but companies usually appoint a high ranking official.

<sup>220</sup> Companies Law of the PRC, *supra* note 210, at ch. III, art. 38.

by registration authorities, commits fraud, secretly withdraws or transfers funds, or engages in other illegal activities.<sup>221</sup> The existence of the legal representative ensures the PRC government that there is always a flesh and blood person who will be responsible to PRC authorities for violations of the law by legal “persons,” such as a business enterprise;<sup>222</sup> PRC authorities did not want ultimate civil or criminal liability to rest solely with a legal fiction while natural persons escaped responsibility.<sup>223</sup>

By identifying a business entity’s legal representative through requiring submission of its business license, Internet sites such as Alibaba would provide the brand owner with a flesh and blood person against whom it can directly bring a complaint in a civil lawsuit under the PRC Trademark Law<sup>224</sup> or Anti-Unfair Competition Law<sup>225</sup> or whom the Public Security Bureau (the police) can arrest under the PRC Criminal Law.<sup>226</sup>

With these requirements, brand owners would not be limited to using the Internet provider’s internal enforcement mechanism, such as the notice and takedown procedures. As PRC law requires that the business operator make its business license available on the Internet platform and as business licenses are publicly available on the AIC websites, the brand owner does not need

<sup>221</sup> General Principles of Civil Law of the People’s Republic of China, Article 49:

Under any of the following circumstances, an enterprise as legal person shall bear liability, its legal representative may additionally be given administrative sanctions and fined and, if the offence constitutes a crime, criminal responsibility shall be investigated in accordance with the law:

- (1) conducting illegal operations beyond the range approved and registered by the registration authority;
- (2) concealing facts from the registration and tax authorities and practicing fraud;
- (3) secretly withdrawing funds or hiding property to evade repayment of debts;
- (4) disposing of property without authorization after the enterprise is dissolved, disbanded or declared bankrupt;
- (5) failing to apply for registration and make a public announcement promptly when the enterprise undergoes a change or terminates, thus causing interested persons to suffer heavy losses;
- (6) engaging in other activities prohibited by law, damaging the interests of the State or the public interest.

General Principles of the Civil Law of the PRC, *supra* note 51, at ch. II, art. 49.

<sup>222</sup> Companies Law of the PRC, *supra* note 210, at ch. III, arts. 38 & 49.

<sup>223</sup> *Id.*

<sup>224</sup> Trademark Law of the People’s Republic of China, *supra* note 97.

<sup>225</sup> Law Against Unfair Competition of the People’s Republic of China, *supra* note 97.

<sup>226</sup> Selling counterfeits is violates Article 140 of the Criminal Law of the People’s Republic of China. See Criminal Law of the People's Republic of China, ch. III, art. 140 (promulgated by the President of the PRC, Order No. 83, March 14, 1997,).

to go through the Internet provider to obtain the necessary information to directly pursue the business operator.<sup>227</sup> Instead, the brand owner can immediately act against the legal representative listed in the business license upon discovering an offending webpage or posting rather than be subject to the long and frustrating delays of the notice and takedown procedures. Of course, the brand owner can also use the Internet provider's internal procedures in addition to bringing an action directly against the business operator through PRC enforcement authorities or, under some circumstances, in the United States if the offender has sufficient U.S. contacts.<sup>228</sup>

The use of an enforcement method that does not rely on the active participation of the Internet commerce site is particularly useful in the case of Alibaba, which the PRC authorities themselves have identified as viewing itself above the law. Any method of enforcement against counterfeiters that requires the active participation of Alibaba could be met with half-hearted efforts or resistance, as many brand owners have persistently suspected and complained. Directly pursuing the counterfeiter will also relieve brand owners from the burden of having to use Amazon's convoluted internal procedures.

### *3. Verification and Deterrence*

Requiring, verifying, and displaying seller information should create an effective deterrent against selling counterfeits on Alibaba and other Internet platforms since fewer counterfeit sellers would even turn to the platform in the first place if such sufficient safeguards were in place. Counterfeiters always rely on the use of false identities, false names, and false addresses because they are fearful of detection, capture, arrest, and prosecution.<sup>229</sup> This is true of counterfeiters who sell in brick and mortar outlets as well as counterfeiters who sell on the Internet. The essential tools of the counterfeiter are secrecy, subterfuge, and artifice. The counterfeiter relies on these tools to disappear at the first sign of trouble. Denying the counterfeiter the use of these tools of secrecy and disguise would force the counterfeiter to operate openly and transparently subject to legal actions in China or in the United States, a prospect that counterfeiters abhor. Many counterfeiters would find the price of transparency and the risks of capture too high a price to pay for operating on the Internet and, as a result, will be deterred from registering on Internet platforms.

Currently, however, as the SAIC notes, Alibaba "only pays lip service"<sup>230</sup> to verifying information. The SAIC specifically criticized Alibaba for numerous careless and lax practices in

<sup>227</sup> A similar procedure can be used in the case of sole proprietorships that would require individuals to register, i.e. Alibaba should do a strict review of the identity card of the registrant. "A natural person who intends to engage in online product transactions shall carry out business activities via a third-party transaction platform, and submit to the third-party transaction platform his/her name, address, valid identity proof, valid contact details and other real identity information." General Principles of the Civil Law of the PRC, *supra* note 51, at ch. I, art. 7. The same principle applies: identifying the name and address of a flesh and blood person who can be held civilly and criminally responsible can be an effective deterrent against counterfeits on Alibaba websites.

<sup>228</sup> It would be possible to file an action against a Chinese counterfeiter in the United States only if the counterfeiter is subject to the territorial jurisdiction of U.S. courts under the minimum contacts standard set forth in *International Shoe v. Washington*, 326 U.S. 310 (1945) and its progeny.

<sup>229</sup> This observation is based on the author's own extensive experience in pursuing counterfeiters in China and in the United States.

<sup>230</sup> SAIC WHITE PAPER, *supra* note 31, at 13.

its examination of business licenses that fail to verify that the entity named in the business license was the user of the license.<sup>231</sup> A review of the Alibaba webpages contained in the Appendix indicates the business operator has not displayed or provided access to its business license on its webpage as required by Article 23 of the MAOT.<sup>232</sup> At present, many individuals register on Alibaba's websites by using false identification papers, sets of which—as the SAIC noted—can be purchased on Alibaba's websites.<sup>233</sup> Under its guidelines, Amazon does not require Internet sellers from China to submit an AIC business license or identify a legal representative. Currently, Amazon only requires a business name, a telephone number, and some form of personal identification, and, as a result, many vendors provide fictitious information.<sup>234</sup>

#### *4. Amazon and PRC Law*

Although Alibaba is clearly subject to the SAIC Measures on the Administration of Online Transactions, it is arguable that Amazon is also subject to these provisions as applied to business entities in China that register on Amazon. Under traditional choice of law principles, the physical location of the business entities in China provides a basis for choosing Chinese law to govern the matter of the registration of those entities.<sup>235</sup> Even if choice of law rules do not dictate the application of the SAIC Measures, nothing prevents Amazon from choosing on its own, through a choice of law clause in its contracts with vendors, to follow PRC law and require each Chinese business to submit an AIC business license or a link to the license on its websites as well as requiring the legal representative to undergo registration procedures.<sup>236</sup> This process will allow brand owners in the United States to bring an action directly against business operators in China that use offending webpages or posts on Amazon in lieu of or in addition to pursuing notice and takedown procedures. As the vast majority of counterfeits originate from China,<sup>237</sup> such measures could be an effective deterrent to counterfeits on Amazon.

#### *5. Consent to Arbitration before CIETAC*

Although not required by MAOT or other PRC law, Internet commerce sites should also include in their registration procedures a clause requiring the resolution of disputes involving foreign elements by arbitration before the China International Economic and Trade Arbitration

<sup>231</sup> “Some online stores that are required to upload business licenses to pass the true name authentication have an entity name, business address, residential information that apparently are not consistent with the entity name, business address or residential address on the business license. Some vendors uploaded business license information of other companies.” *Id.*

<sup>232</sup> See Appendices 1-3.

<sup>233</sup> Transcript of Admin. Guidance Meeting, *supra* note 141, at 98.

<sup>234</sup> *Selling on Amazon: Frequently Asked Questions*, *supra* note 44 (requiring a business name, address, and contact information among other information in order to open an Amazon seller account); see also *supra* note 93 (brand owners find vendors provide bogus information).

<sup>235</sup> Under the Restatement of Conflicts of Law (Second) § 188(2), the following factors would support a finding of PRC law to govern the registration requirements: (a) place of contracting, (c) place of performance, (d) location of the subject matter of the contract, and (e) place of incorporation and place of business of the parties. Restatement of Conflicts of Law (Second) § 188(2) (1971).

<sup>236</sup> Parties can also choose the applicable law through a choice of law provision. *See id.* § 187.

<sup>237</sup> See Part II.A *supra*.

Commission (CIETAC).<sup>238</sup> CIETAC has its headquarters in Beijing and facilities in other cities in China and Hong Kong,<sup>239</sup> it lists many foreign experts among its roster of arbitrators,<sup>240</sup> and parties can choose English as the language of the arbitration.<sup>241</sup> The clause should include a provision that the business operator consents to the arbitration of disputes with the Internet provider or an entity authorized by the Internet provider, i.e., the brand owner.

Arbitration clauses providing for resolution of disputes by CIETAC are now commonly used by many companies to resolve international business disputes that involve China,<sup>242</sup> and arbitration is the normal method for resolving international disputes generally.<sup>243</sup> The advantage of such a clause for the brand owner is the certainty that an action can be filed against the legal representative of the business operator with CIETAC and that CIETAC will have jurisdiction over the respondent. This will allow brand owners to move expeditiously to file an action with CIETAC without having to deal with the uncertainty of preliminary issues such as proper notice and jurisdiction in a court-based litigation. The brand owner will also not need to suffer through the agony of waiting months required by using notice and takedown procedures.

CIETAC awards enjoy a high degree of respect and enforceability in China. PRC law requires parties to implement CIETAC arbitral awards<sup>244</sup> and the awards are enforceable by Chinese courts at the local level.<sup>245</sup> Consent to arbitration before a prestigious entity such as CIETAC would act as a further powerful deterrent to counterfeiters in China, who are used to dodging legal authorities not consenting to appear before them. The threat of being brought before CIETAC should further deter counterfeiters from registering on Internet commerce sites. For those merchants that do register, brand owners will have a quick and effective method of enforcement.

#### IV. CONCLUSION

The dawn of the age of e-commerce in the new millennium opened new possibilities for legitimate commerce, but it also created vast new opportunities for illegal commerce, such as the

<sup>238</sup> China Int'l Econ. & Trade Arbitration Comm'n (CIETAC) Arbitration Rules, art. 3(2) (revised and adopted by the China Council for the Promotion of International Trade/China Chamber of International Commerce on November 4, 2014 and effective January 1, 2015), available at <http://www.cietac.org/Uploads/201904/5caae5be03bb5.pdf> [hereinafter CIETAC Arbitration Rules].

<sup>239</sup> CIETAC Arbitration Rules, *supra* note 238, art. 2(3).

<sup>240</sup> *Arbitrators*, CIETAC, <http://www.cietac.org/index.php?g=User&m=Arbitrator&a=index&l=en> (last visited July 1, 2019).

<sup>241</sup> CIETAC Arbitration Rules, *supra* note 238, art. 30.

<sup>242</sup> See e.g., *Model Clause: China International Economic and Trade Arbitration Commission (CIETAC)*, INT'L TRADE CENT., <http://www.intracen.org/Model-Clause-China-International-Economic-and-Trade-Arbitration-Commission-CIETAC/> (last visited July 1, 2019) (promoting the use of a model arbitration clause using the CIETAC).

<sup>243</sup> CHOW & SCHOENBAUM, *supra* note 55, at 593 (noting that arbitration is now the normal way to resolve international business disputes).

<sup>244</sup> CIETAC Arbitration Rules, *supra* note 238, art. 55(1) ("The parties shall perform the arbitral award within the time period specified in the award. If no time period is specified in the award, the parties shall perform the award immediately.")

<sup>245</sup> CIETAC Arbitration Rules, *supra* note 238, art. 55(2) ("Where one party fails to perform the award, the other party may apply to a competent court for enforcement of the award in accordance with the law.")

sales of counterfeits on a previously impossible scale and level of penetration. This Article has detailed some of the daunting challenges the Internet created for brand owners and the brand owners' numerous but frustrated efforts in dealing with this potent new threat.

This study has focused on the two largest e-commerce sites in the world that dominate online retail services in China and the United States and the lessons learned can be immediately applied to other sites. The kinds of problems that brand owners face on Alibaba and Amazon are both different and similar.

The problems are different in that Alibaba facilitates the sale of counterfeits to satiate the enormous demand for counterfeits by Chinese consumers, whereas Amazon sells counterfeits on its e-commerce site to U.S. consumers who are deceived into buying a counterfeit when they sought to buy a genuine product. Together, Alibaba and Amazon can deliver a crippling one-two punch to brand owners: Alibaba facilitates the sale of counterfeits of their products to those consumers who seek them, and Amazon facilitates the sale of counterfeits to those who do not. Considering that there are other huge e-commerce sites such as JD.com and Tencent in China and e-Bay and Groupon in the United States with similar issues, brand owners are faced with numerous dangerous threats.

The problems are similar in that brand owners find the pursuit of counterfeiters through these two e-commerce giants to be frustrating and ineffective and the direct pursuit of counterfeiters to be futile, as counterfeiters quickly vanish into cyberspace at the first sign of trouble.

Both sets of problems can be remediated through the suggested course of action set forth in this Article. However, while brand owners have made many demands to Alibaba and Amazon to streamline and improving their internal procedures for the monitoring of counterfeits and their notice and takedown procedures, to the best of the author's knowledge, no brand owner has looked closely at PRC law for help despite the urging of PRC officials.<sup>246</sup> Given the poor reputation of China in protecting foreign intellectual property rights,<sup>247</sup> this lack of trust in PRC law is understandable, but information technology tools are available that can be put to effective use. Of course, these tools were not created by the PRC with the goal of protecting foreign brand owners, but instead for the purpose of satisfying China's obsessive need to closely monitor all aspects of Chinese civil society. While China is far behind the United States in protecting intellectual property rights, China is far ahead of most countries in using information technology to monitor and supervise all aspects of Chinese civil society.<sup>248</sup> These tools can provide a level of effective

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<sup>246</sup> See *supra* note 206.

<sup>247</sup> See Daniel C.K. Chow, *The Myth of China's Open Market Reforms and the World Trade Organization*, U. PENN. J. INT'L LAW 8 (forthcoming 2019) (file on copy with the author).

<sup>248</sup> One example is China's recent social credit system, which involves assigning a social credit score indicating the desirability of a citizen's conduct to each citizen in China, a country of over 1.38 billion people. See *supra* note 42. There is also a more menacing side to China's use of technology in monitoring its citizens. Critics have argued that China has used advanced technology to create an "all seeing police state" in the rebellious Muslim dominated area of Xinjiang Province. See *China's Hi Tech Police State in Fractious Xinjiang a Boon for Security Firms* (June 27, 2018), <https://www.scmp.com/news/china/diplomacy-defence/article/2152749/chinas-hi-tech-police-state-fractious-xinjiang-boon>.

deterrence to Chinese counterfeiters that seek to sell their illegal wares on Internet commerce sites based in China or the United States. Brand owners can use these tools, as detailed in this Article, on their own or in conjunction with existing and developing new tools through Internet commerce sites together as an overall strategy of deterrence.

To be able to use the tools discussed in this Article, brand owners only need to insist on what they have every right to receive: e-commerce sites in China, such as Alibaba, must faithfully obey relevant provisions of PRC law that are simple and straightforward, an area in which Alibaba falls far short;<sup>249</sup> and e-commerce sites in the United States, including Amazon, should apply PRC law on entity registration of Chinese business operators under traditional choice of law rules, a choice of law clause, or voluntarily. Verification of entity registration should become easier with the enactment of proposed new data security legislation that would impose civil and criminal liability for the misuse of electronic information.<sup>250</sup> Entities that register on e-commerce sites could become liable for the use of false, misleading, or inaccurate business licenses and thus would have an additional legal incentive to use business licenses accurately.<sup>251</sup>

Alibaba poses a particularly formidable challenge to brand owners due to its overwhelming size and power within China and its leading role in facilitating the online sale of counterfeits. Alibaba's prodigious wealth and strength has led, in the words of PRC officials, to a culture of "arrogance."<sup>252</sup> Brand owners have suspected for years that Alibaba tacitly tolerates and supports counterfeiting in order to earn revenue from these sales. Recently, PRC national government authorities have confirmed these suspicions as the result of an extraordinary national level intervention intended to discipline Alibaba. Beyond tolerating and supporting counterfeiting, Alibaba, in the words of PRC national authorities, views itself as above the law and unafraid of and not intimidated by PRC enforcement authorities.<sup>253</sup> In fact, the opposite seems to be the case, as the 2014 investigation of Alibaba by the SAIC indicates: government authorities are reluctant to seriously discipline Alibaba or its business due to Alibaba's exalted stature and reputation as a national paragon in China.<sup>254</sup> This raises a deeper issue with Alibaba for brand owners, as this attitude is unlikely to change without intervention by the highest levels of the Communist Party, a topic that deserves further scholarly exploration but is beyond the scope of this Article.

The proposed course of action described in this Article has the advantage of not having to rely on Alibaba's active participation; all that is required is that Alibaba mechanically apply the law as is required for registration of online vendors, and brand owners can on their own enforce their rights against offending parties in civil and criminal actions in China or the United States. The proposals set forth in this Article also apply to problems that brand owners face on Amazon and other U.S.-based e-commerce sites, so long as these sites apply PRC law as a result of choice of law analysis, a choice of law clause, or voluntarily. So long as Amazon follows PRC law in entity registration verification, brand owners can proceed directly with legal actions against

<sup>249</sup> See *supra* Part II.D.2.

<sup>250</sup> Article 4 of the PRC Draft Security Measures for Data Security Management, [https://www.insideprivacy.com/wp-content/uploads/sites/6/2019/05/Measures-for-Data-Security-Management\\_Bilingual-1.pdf](https://www.insideprivacy.com/wp-content/uploads/sites/6/2019/05/Measures-for-Data-Security-Management_Bilingual-1.pdf).

<sup>251</sup> *Id.*

<sup>252</sup> See *supra* text accompanying note 151.

<sup>253</sup> See *supra* text accompanying notes 151-156.

<sup>254</sup> See *supra* text accompanying note 182.

counterfeitors and infringers in China or the United States and are not relegated to the misery of relying solely on Amazon's convoluted and cumbersome internal procedures.

Ironically, while most brand owners have focused their attention on streamlining the internal monitoring procedures of Internet e-commerce sites, they have ignored the more effective tools that are available in plain sight in China's legal system. By using these tools created by China's obsessive need to closely monitor and control all aspects of its civil society, brand owners can help to deter counterfeiters by forcing them to shed their concealment and anonymity and by exposing them to what they fear and loathe the most: transparency and accountability for their illegal actions.

## V. APPENDICES

### Appendix 1. *Alibaba Listing: Gucci Guccio Handbags*



高端定制大牌  
gucci guccio天...



使用淘宝扫一扫

¥1500

03月29日前有效

Appendix 2. *Alibaba Listing: Hennessy XO*



轩尼诗XO干邑白  
兰地 法国Henne...



使用淘宝扫一扫

¥432

03月29日前有效

Appendix 3. *Alibaba Listing: Abercromie & Fitch Sweatpants*



秋冬款加绒AF运动  
裤女小脚加厚长...



¥80

使用淘宝扫一扫



保存图片  
到相册



打开淘宝  
立即看见

Full Image (215K)  
04月01日前有效



Appendix 4. *Abercrombie & Fitch Sweatpants*

