

**Global Congress on Combating Counterfeiting and Piracy**

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Thank you, Mr. Chairman, for that kind introduction and thank you to the organizers for the opportunity to address this distinguished gathering of experts.

Today, I would like to talk about the organized crime of cigarette counterfeiting. I will highlight the social and economic consequences of that crime and call for the rigorous and consistent application of a potentially effective deterrent.

Most consumers have been exposed to counterfeits of luxury goods, clothing or pirated DVDs or software, whether on vacation, through the internet or even in their own neighborhoods. These forms of counterfeiting and piracy receive widespread media coverage and there is no lack of awareness of the prevalence and seriousness of the issues.

On the other hand, since the majority of adults are non smokers, many, if not most, people will never have encountered a counterfeit cigarette. As a consequence, the general public is not aware of this multi billion dollar criminal enterprise and the damage it causes.

That is a serious concern for us as a brand owner and we are devoting significant resources to tackling the problem.

But I want to suggest to you today that the concern should be felt much more broadly by Society at large and that governmental action to address the growing threat needs to be intensified.

### **The Issue – Dimensions and Growth**

Cigarette counterfeiting first emerged as a significant threat in the early 1990's. At that time, it was largely confined to Asia, the volumes were relatively modest and manufacturing was centered in countries such as Vietnam, Indonesia and China. The products, too, were largely distributed within Asia.

The quality of the fake packaging at that time was not particularly high – we would often see elementary mistakes, making the counterfeits easy for consumers and law enforcement to spot, for example, the legend “MADE IN USA” on counterfeits of *Marlboro* soft pack frequently appeared as “MANE IN THE USA”.

But over the past decade a number of disturbing trends have emerged.

There has been an explosive growth in the volumes of counterfeit cigarettes produced. The World Customs Organization estimates that 190 billion counterfeit cigarettes are produced in China alone each year. To put that number in perspective, it is roughly equivalent to the total legal sales in Mexico, Argentina and Brazil combined.

It is worth pausing here to note that China is itself as much the victim of cigarette counterfeiting as the international manufacturers. Perhaps half of the counterfeits produced are of Chinese brands.

In China, hundreds, if not thousands, of small cigarette counterfeiting factories exist. Often these operations would not be recognizable as factories – being, literally, holes in the ground.

But this is no cottage industry. On the contrary, this cell-like structure has been deliberately adopted by the counterfeiting syndicates in order to avoid disruption to production if a factory is detected and raided by the authorities.

The Chinese authorities have raided thousands of the facilities each year and yet the problem persists. In truth, this has become something of a War of Attrition.

Production of counterfeit cigarettes has spread both within Asia, to rogue states such as North Korea, and west to include the Middle East, Eastern Europe (particularly Russia and Ukraine) and the European Union.

The spread into the EU is a direct consequence of the dismantling of the EU's internal borders. The free movement of goods within the EU has substantially lowered the risk profile for the criminal gangs and at the same time significantly increased the profitability of this activity by providing easy access to high price markets. This proves once again that criminals are highly adept at taking advantage of political and economic developments intended to benefit legitimate business and consumers.

Since 2005 we have raided and closed 32 factories counterfeiting our brands in the EU, but we are seeing similar cell structures to those adopted in Asia – multiple factories in Central Europe under common control to ensure continuity of production.

The quality of the packaging of the fakes has improved dramatically – the elementary mistakes are gone and the counterfeiters are seeking to source the materials from the legitimate suppliers – even to the point that one counterfeiter operating from North Korea was seeking not just red ink, but *Marlboro* red ink from our own supplier at the time.

Sales of counterfeit cigarettes have now spread across the world. The parallel distribution networks have become well established and well entrenched. Counterfeits are sold openly on the streets of many European cities. In Hong Kong home delivery services exist, elsewhere orders are taken and products are delivered at factories and other workplaces. In the UK specific houses are known locally as the place to buy illegal cigarettes (the so called “tab houses”).

These networks channel billions of cigarettes into the hands of consumers, without payment of tax or complying with any of the applicable regulations, including minimum age laws or local language health warnings.

### **Key Drivers for Growth**

The key drivers for this explosion in cigarette counterfeiting are: (a) profit and (b) rising demand.

We estimate that the available profit in the supply chain between the factory gate and the sale on the streets of an EU market such as the UK or Ireland could be \$2.3 million for just one forty foot shipping container (9.6 million cigarettes).

If we assume that half of the counterfeit cigarettes produced in China (an estimated 95 billion cigarettes) are exported and sold at similar prices, the ex - China business alone could be worth \$23 billion a year to the criminals involved.

Driven by high taxes, legitimate cigarettes are expensive in many markets and the demand from consumers for inexpensive alternatives in those markets is strong and, in a recession, growing stronger.

In the United Kingdom, for example, cigarettes cost around \$9.50 for a pack of 20 and consumers will readily pay \$5 for a pack of illegal, often counterfeit, cigarettes on the streets.

### **Social and Economic Consequences**

The social and economic consequences of this trade are such that it is time to recognize that to place the burden entirely on the shoulders of brand owners, categorizing this as purely an IP issue, is not an appropriate response from governments.

Those social consequences include:

- Reducing Government tax revenues and undermining health policies
- Creating opportunities for corruption and money laundering

- Drawing the unemployed into criminal behavior by selling smuggled counterfeit cigarettes
- Sending mixed messages to our communities by appearing to tolerate visible, daily law breaking – street vendors selling counterfeit cigarettes on the streets
- Depriving legitimate retailers, many of them small family businesses, of revenues from sales of legitimate cigarettes which are vital to their survival

### **Deterrents**

The civil remedies open to brand owners (such as damages, an injunction and delivery up or destruction of counterfeits) while tactically important, have their limitations in the context of counterfeiting on the scale which I have described.

It seems doubtful that civil remedies will, in and of themselves, provide a long term solution to this serious social problem.

Civil damages – if they can be recovered – are generally aimed at compensating the brand owner, rather than deterring or penalizing the counterfeiter. To make a real difference we need to focus on true deterrents as part of a broad strategy to stem the growth not only of cigarette counterfeiting but other forms of transnational counterfeiting and piracy.

Counterfeiting is a business – a criminal business – but a business. And cigarette counterfeiting is an enormously profitable business, involving relatively modest risks for the syndicates.

But we can change the dynamic and deter criminals from entering or continuing in the counterfeiting business by routinely seizing the proceeds of crime and earmarking the funds for use by law enforcement in the fight against counterfeiting and piracy.

In certain jurisdictions the legislative and enforcement tools to do what I propose exist today and they are being applied.

- **Hong Kong** has the *Organized and Serious Crimes Ordinance* (or “OSCO”) which includes both trademark counterfeiting and copyright piracy within its scope.
- OSCO allows the Courts to order the confiscation of the proceeds of crime. Importantly, in exercising that power the Court is allowed to make certain assumptions which effectively reverse the burden of proof.
- The Court can assume that any property held by the person convicted of an organized crime within the six years prior to his conviction are the proceeds of organized crime (and not necessarily the crime of which he has been convicted), unless the Defendant can prove that assumption to be incorrect.
- The Ordinance also provides a mechanism for ensuring that Confiscation Orders are effective – the Court can make an order, fixing a term of imprisonment which the Defendant

must serve if any of the amounts specified in the Confiscation Order are not paid.

- The Courts have enhanced sentencing powers in organized crime cases under OSCO. They can impose additional sentences of up to one third of the normal tariff.
- The **UK's** *Proceeds of Crime Act* includes similar forfeiture provisions and has been described by the UK Government's Intellectual Property Office as. "*ideally suited to providing adequate sanctions for high level IP criminals*"
- In July this year, the Act was used in Operation Stormgrand against a major counterfeit drugs syndicate to recover more than £3 million
- **South Africa's** *Proceeds of Crime Act* also allows the authorities to seek the forfeiture of the proceeds of crime, including dealing in counterfeit goods. That power was used recently for the first time in a movie piracy case (November 2009).
- The **US** Department of Justice and the Secret Service demonstrated how powerful and effective the criminal law can be in solving the most complex and seemingly intractable counterfeiting issues. A syndicate which was producing counterfeit US Dollars and counterfeit *Marlboro* cigarettes in North Korea was broken after US authorities arrested the heads of the syndicate in Saipan in 2004. The 3

defendants were tried in Washington DC, convicted and sentenced to between 4 and 5 years in Federal Prison. The proceeds of crime held in Hong Kong and US bank accounts were forfeited to the US and Hong Kong governments.

## **Conclusion**

To sum up, we can say today that cigarette counterfeiting has become a multi billion dollar global enterprise run by agile and adaptable criminal gangs. It has serious consequences for Society including brand owners.

The long term impact of the civil tools which are at the disposal of brand owners can be limited and therefore, in order to achieve a meaningful breakthrough in this War of Attrition, we need to see the enactment and rigorous application of laws allowing for the forfeiture of the proceeds of crime and the reuse of those funds in the continuing fight against counterfeiting and piracy.

The tools exist in some jurisdictions – Hong Kong, the UK South Africa and the US for example – but in many, including some where this business is flourishing – the option of forfeiture is not available in counterfeiting cases or that option is underutilized. That must change so that criminals are consistently deprived of their profits.

Thank you for your attention