High Level Risk Forum

European Commission Position Paper: Supply Chain Integrity in the Global Fight against Counterfeiting and Illicit Trade

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This Report is provided by the European Commission’s Directorate General Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) to the OECD Task Force on Countering Illicit Trade to discuss frameworks of action to reduce the infiltration of illicit trade into supply chains by engaging actors such as intermediaries. Members are encouraged to review and discuss the findings of this report, including the proposed solutions for addressing these risks and ways in which these solutions may be practically implemented.

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INTRODUCTION

1. Protecting legitimate supply chains from counterfeiting has become a significant challenge over the past years as a growing number of industry sectors have been reporting cases of infiltration of counterfeiting products into their supply chains and/or diversion of products such as unauthorised overruns or end-of-life product parts. For instance, the electronic sector has been expressing strong concerns about the detection of counterfeit electronic parts in the legitimate supply chain. Such detection has even been reported in the defence supply chain in the US as well as in Europe.

2. Several factors contribute to this phenomenon. First, global supply chains constitute a complex and large network of actors involved in production and distribution processes. In such circumstances, many companies find it difficult to map and monitor their suppliers and sub-suppliers beyond the second tier of their supply chains. This limited visibility results in lower control over the supply chain and thereby increased exposure to a variety of risks such as counterfeiting. In some cases, these vulnerabilities allow illicit networks to penetrate legitimate supply chains and exploit the services provided –wittingly or unwittingly- by supply chain intermediaries.

3. Therefore, it becomes urgent to take the necessary measures to better protect legitimate supply chains from counterfeiting threats, including by enhancing cooperation between supply chain actors and actively promoting transparency and best practices.

4. Such an approach –far from being isolated- echoes other policies developed in a vast number of fields (e.g: customs, corporate social responsibility) in order to enhance due diligence of supply chain actors and thereby reduce threats and violations to rights and standards. IP enforcement would learn immensely from such policies and would gain from exploring existing options aimed at securing supply chains.
1. Counterfeiting threats within the licit supply chain: a major and urgent problem

1.1 Counterfeiting strategies affecting the supply chain

5. A large number of stakeholders have been drawing attention to the counterfeiting activities that threaten legitimate supply chains.

6. First, in 1998, the OECD's report on the Economic Impact of Counterfeiting\(^1\) showed that counterfeit products were often made by the same manufacturer that was contracted to produce the authentic product. Recent research also stresses that counterfeiting strategies are increasingly sophisticated as counterfeiters apply the same technologies and use the same suppliers as legitimate brands\(^2\). Thus, a variety of counterfeiting strategies has emerged and affects the legitimate supply chain such as:

- genuine parts or products are stolen from the legitimate supply chain (e.g: disposed-of genuine products are recovered)
- factory over-runs or near copies are illegally produced by sub-contractors
- counterfeit products and genuine products are bundled and distributed together

7. Other findings reveal the existence of interactions between legitimate and illegitimate supply chains in the fashion and luxury industry\(^3\). There seems to be 2 types of interactions between the legitimate supply chain and the illegitimate supply chain:

- Diversion from the legitimate supply chain (diversion of ideas, components, final products, parallel and grey markets, factory overruns)
- Infiltrations into the legitimate supply chain (infiltration at the warehouse/distribution level or retailer level)

8. A number of industries have also expressed strong concerns about this issue such as the microelectronics industry. According to a study carried out in the US by the Electrical Safety Foundation 64.2% of counterfeit electrical goods are purchased from legitimate shops and retailers\(^4\).

9. In a paper published in 2014, the Institute of Electrical and Electronics Engineers (IEEE) identified no less than 7 general typologies of counterfeit electronic components detected in legitimate supply chains\(^5\). They are classified as recycled, remarked, overproduced, defective, cloned, forged documentation, tampered.

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10. Many sectors are affected by the infiltration of counterfeit electronics including the defence supply chain. In 2012, the US Senate Committee on Armed Service announced that over 1 million counterfeit parts had infiltrated the US Defence supply chain and the majority originated from China. Likewise, in a report published in 2016, the United Nation Interregional Crime and Justice Research Institute (UNICRI) found that like in other sectors, organised criminal networks manipulate legitimate supply chains and use various techniques to move illicit pesticides throughout supply chains and consumer networks without detection or seizures.

1.2 Case studies: Aston Martin and Johnson & Johnson

- **Infiltration of Aston Martin's supply chain with a counterfeit component**

11. In 2014, Aston Martin was forced to recall over 17,000 cars as they found out that their Chinese sub-supplier had made the accelerator pedal of their cars with counterfeit Dupont plastic which presented a risk to their consumers' safety. The infringement was committed by a supplier and affected a third party's IP (Dupont's trademark). It also jeopardised consumers' safety and Aston Martin's reputation. This led Aston Martin to stop contracting with this supplier and to be directly supplied by Dupont's distributor.

- **Infiltration in and diversion from Johnson & Johnson's supply chain**

12. In 2001, Johnson & Johnson’s Medical Device & Diagnostics (MD&D) suspected that legitimate products were being diverted from their supply chain and distributed to unauthorised dealers. Two years later, in 2003, the company carried out quality tests on some of their surgical devices for which doctors had raised quality concerns. The tests revealed that these devices were counterfeit.

13. The company launched an investigation into the problem and learned that MD&D’s operating companies had also been experiencing similar problems. The analysis of the problem also revealed that the brand protection strategies within the group were disparate and due diligence processes were partial. Furthermore, the supply chain was not sufficiently robust. Last but not least, the company did not know the route the product followed after it had left the company's plants and distribution centres. In order to address these issues, MD&D developed a risk management policy.

2. Ensuring the integrity and security of legitimate supply chains

2.1 Supply chain risk management: a needed strategy

14. The counterfeiting problems encountered in legitimate supply chains originate from the complex structure of the latter. Supply chains are defined as "networks of entities through which material flows".

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9 Jerry Wald, Jack Holleran, "Counterfeit products and faulty supply chains", (2007), Risk Management

15. Over the past 30 years, these networks have globalised and rapidly expanded thereby often becoming fragmented "supply webs"\(^{11}\).

16. Furthermore, the emergence of new technologies and the internet has helped infringers to improve their counterfeiting techniques to infiltrate legitimate supply chains.

17. In this context, the absence of due diligence, the lack of solid risk management strategies and limited cooperation between supply chain actors critically weakens the security of the supply chain, which results in escalating levels of counterfeiting that harm businesses and citizens.

18. Yet, despite the emergence in the past two decades of strategies and policies aimed at securing global supply to address supply chain disruption caused by all sorts of risks ranging from natural disasters, terrorism attacks, quality problems, laws and regulation infringements to safety issues just to name a few, the protection of IP from a supply chain management angle remains all too often ignored or neglected by companies as some IP experts report\(^{12}\). Policy makers have also failed to adapt their policies to address this problem.

19. For instance, in the EU the security and integrity of supply chains are addressed in a wide range of initiatives both regulatory such as the Falsified Medicine Directive, the Authorised Economic Operator (AEO) regime or the Timber Regulation and non-regulatory such as guidelines on Corporate Social Responsibility or Non-financial reporting. However, there is no EU or international policy framework aimed at encouraging due diligence in supply chains to avoid counterfeiting.

20. IP enforcement in supply chains could learn from these initiatives and would certainly benefit from a policy promoting supply chain risk management and due diligence. Experts and chambers of commerce have started providing suggestions and recommendations to tackle supply chain weaknesses.\(^{13}\)

2.2. Actions to address the problem of the vulnerability of supply chains being infiltrated by counterfeits

21. In order to enhance supply chain integrity and thereby prevent counterfeiting threats from affecting legitimate supply chains, the European Commission suggests addressing the following points in the Task Force:

(i) Adopt a holistic strategy for supply chain protection

- Map risk management tools and due diligence strategies used in other policy areas to protect supply chains and determine whether they may be applied to the fight against counterfeiting.

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\(^{11}\) Today, many stakeholders refer to supply chains as "supply webs" in order to emphasize the gigantic aspect of these networks.


• Extend existing standards and accreditation processes to IP enforcement and the fight against counterfeiting.

• For instance, the European Commission negotiated the introduction of IP enforcement provisions in the new ISO Standard 20400 "Sustainable procurement", due to be adopted early 2017. Another interesting option would be to grant the Authorised Economic Organisation (AEO) status to intermediaries who comply with IP enforcement standards.

• Link the fight against counterfeiting with other strategies against illicit trade in order to adopt common tools.

(ii) Clarify the role of intermediaries in securing supply chains and fighting counterfeiting

• Promote MoUs between rights holders and intermediaries.

• Encourage best practices such as the "Know Your supplier" strategy.

• Create an "IP culture" throughout the supply chain.

(iii) Enhance the use of technology for securing supply chains and fighting counterfeiting

• Determine whether an innovative technology such as Blockchain may be applied to protect supply chains from counterfeiting.

  This technology is already used to protect the diamond supply chain from the infiltration of blood diamonds and from fraud. A transposition of such an application in the field of IP enforcement would certainly highly benefit the fight against counterfeiting.

• Ensure that track and trace systems and authentication technologies are accessible and affordable to SMEs. In some industry sectors, SMEs constitute the vast majority of companies.

(iv) Encourage consumers to contribute to the fight against counterfeiting

• Enhance consumer empowerment, for example by promoting authentication technologies. For instance, some authentication applications may already be downloaded on smartphones in order to ensure that a product is authentic.

• Enhance cooperation with consumers associations.

  Consumer associations are closer to consumers and they play thereby an important role in informing and communicating with them.

• Link awareness raising campaigns on counterfeiting with issues such as CSR and responsible buying and consuming. More specifically, remind/inform that IP crime is also a social, health and environmental threat and that it is may be used to finance other serious criminal activities and organised crime.
REFERENCES


Wald, Jerry, and Holleran, Jack, “Counterfeit products and faulty supply chains” (2007), Risk Management