

Faked in China: Inside the Pirates' Web

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A counterfeit LVMH handbag purchased and shipped from a Chinese-based web site being displayed outside a Louis Vuitton store in Chevy Chase, Maryland. **Hyungwon Kang**

Anybody could tell right away that the Louis Vuitton shoulder bag was fake because it was delivered in a recycled box that once shipped batteries.

Warnings printed on the inside of the box read: "Danger Contains Sulfuric Acid" and "Poison – Causes Severe Burns" — not the sort of messages that would normally accompany a product from one of the world's most iconic luxury brands.

But it sure looked real. It was dark brown, sported a braided strap with brass fittings and the Louis Vuitton monogram stamped all across the bag.

I had ordered the bag from a web site called www.ericwhy.com for this special report, which explores the growing problem of counterfeit merchandise sold over the Internet.

Reuters wanted to trace the problem from a consumer in Washington to the shadowy producers based in Guangzhou, China, where my colleague Melanie Lee found the illicit workshops and markets.

Ericwhy, based in Guangzhou, calls its stuff "designer-inspired alternative to actual Louis Vuitton" in a disclaimer on its web site. "We assume no civil or criminal liability for the actions of those who buy our products."

Yet, U.S. law enforcement officials say this web site and many others that offer a dazzling array of goods online — clothes, electronics, footwear, watches, medicines — are outlaws, and they plan to go after them hard.

Counterfeit commerce over the Internet has soared in the past couple of years, turning what had been an irritant to businesses into a serious competitive threat, the officials say.

The Organization for Economic Cooperation and Development estimates that the amount of counterfeit goods and pirated copyrights in world trade grew from about \$100 billion in 2001 to about \$250 billion in 2007, the last year for which they have made an estimate. While there are no separate estimates for how much of that is sold on the Internet, authorities say it is considerable.

"The Internet has just completely changed the face of the problem, made it more complicated and more pervasive," says John Morton, assistant secretary in charge of U.S. Immigration and Customs Enforcement, or ICE. "Whole industries now have been attacked, not from the street, but from the Internet."

Visitors to www.ericwhy.com can choose from more than 1,800 imitation Louis Vuitton bags, ranging from a pink shoulder tote and a tiger-colored "Whisper bag" to a simple bright red clutch.

The one I ordered cost \$122 with a \$40 shipping fee, so by my definition it was not exactly cheap. But comparable bags sold at a local Louis Vuitton retail store were \$1,000 or more.

I entered my Washington address and credit card information, and instantly got an e-mail from my credit card company warning of possible fraud on my account. Soon, I received a second e-mail, this one a receipt with a Worldwide Express Mail Service tracking number so I could follow my package.

The bag left Guangzhou, China, on Sept. 14 and arrived on my desk by the 20th. It was wrapped in a yellow sheath with the Louis Vuitton logo and smelled strongly of leather.

But in another sign something was not quite right, the English instructions that came with it read: "Louis Vuitton has created for you prestigious glazed leather" — the sentence ending abruptly without the word "bag."

I took the bag to a Louis Vuitton store in Chevy Chase, Maryland, to see how it compared with the real article. The store clerk, a tall man in a stylish suit, was restrained. "We only talk about our own products," he said icily, adding, "We don't have any bags like that."

That Louis Vuitton doesn't want its store personnel to talk about how easily their products can be copied is perhaps understandable. If word got around that fake bags were on the street, then people might begin to wonder whether their own bags were real. Part of the brand's cachet is its exclusivity, which easily available counterfeits devalue.

Last year, U.S. customs and other law enforcement agents made nearly 15,000 seizures of counterfeit goods, 80 percent of which came from China. Handbags were third on the list, behind consumer electronics and footwear — the top item for four consecutive years.

"They aren't just selling counterfeit clothing or electronics," U.S. Attorney General Eric Holder told a recent intellectual property conference in Hong Kong. "They're selling defective and dangerous imitations of critical components, like brake pads, or everyday consumer goods, like toothpaste. They're conducting corporate espionage. They're pirating music, movies, games, software and other copyrighted works — both on our cities' streets and online. And the consequences are devastating."

When it comes to making counterfeit goods and pirating brands, China is the counterfeit "workshop of the world." Along with a relentlessly widening U.S. trade deficit, which Washington blames on China's undervalued currency, rampant piracy is stoking economic tensions between two of the world's biggest economies.

Shady Factories

The grubby town of Shiling, an hour's drive from the southern port of Guangzhou, has the biggest leather-working industry in China. In the 1980s, multinationals from various industries began outsourcing production to factories in the coastal provinces. In this part of the Guangdong province, it was leather.

By the late 1990s, low-budget workshops in inconspicuous neighborhoods near the outsourcing factories had sprung up making fake versions of the products. Today, much of Shiling's leather goods are destined for the counterfeit trade.

At one such workshop near Shiling Secondary School, women and their young daughters could be seen cutting and sewing leather by the windows. Lanky men loitered on the ground floor by a "help wanted" poster seeking leather workers, serving as lookouts.

These places are occasionally targeted for police raids.

Zhou She, a private investigator whose job is to sniff out illicit hives of counterfeiting operations, told us about this cluster of workshops, but we must act discreetly, he said.

Walking gingerly around the three-story shop-house factories and watching men and women pound metal hardware into leather in the back alleys, it feels like we are in a pirates' lair.

Police officials say organized crime gangs, sometimes called triads in this part of China, are deeply involved, given their extensive underground networks. "Of course, they are involved. It is very low risk for them," Zhou said.

He works the detective gumshoe routine, spending hours trailing trucks carrying suspected cargo in and out of Shiling, conducting camera surveillance and interviews.

A former People's Liberation Army intelligence officer, Zhou, who has been in the industry for 12 years, has the tanned, leathery skin and sharp crew cut of a military man. His austere presence is betrayed only by a brown, expensive-looking leather purse, which he showed off proudly — a gift from an Italian client after he found a counterfeit workshop for them.

Luxury brands hire him to gather information on the location of warehouses and factories, which then use that evidence to persuade Chinese police to conduct a raid.

The workshops take real luxury handbags and reverse engineer them. Everything from the metal fittings to the monogrammed leather of a Louis Vuitton bag is produced in China.

After it is put together at one of the workshops in Shiling, the bag usually winds up in nearby Baiyun, by the old airport in northern Guangzhou.

Leather Bazaar

The Guangzhou Baiyun World Leather market is the epicenter of the world's counterfeit trade when it comes to wholesaling fake leather goods and apparel, experts said.

Counterfeit Louis Vuitton, Gucci, Prada and Hermes handbags literally spill out of shops that occupy commercial space the size of five football fields. Smaller stores provide auxiliary products, such as counterfeit paper bags, receipts and catalogues for wholesalers.

Gina, who declined to give her surname, is one such wholesaler from Colonia, Uruguay. Tugging a large, gray Louis Vuitton suitcase through the narrow paths of the leather market with her 66-year-old mother in tow, she is looking for a shop that can make Louis Vuitton satchels out of "pleather" (synthetic leather).

"Don't worry, she can manage, we are very used to this," Gina said as her arthritic mother slowly shuffled forward, carrying bags laden with fake scarves and leather goods, before they stopped at a bag shop.

"I don't need real leather, just pleather. No need to be 5-As, just double-A enough," Gina told the shopkeeper in heavily accented English.

She has traveled halfway around the world to Baiyun to make a personal connection in the world's largest market for counterfeit leather goods. "I used to buy online from China, but after one bad experience, I said never again!" She said she wound up taking a delivery of 800 bags in red instead of the black she ordered.

Gina was looking for a factory that can make 500 satchels, which she planned to ship to Argentina before bringing them into Uruguay where she has a beachfront store. It's less suspicious to bring it over the border than have it come directly from China. Clutching sheets of paper with information about the bags she wants made, Gina, with her streaked blond hair, tanned skin and branded accessories, looked more like a Hollywood fashionista than somebody's idea of a pirate. "I've been in this business for eight years now," she said. "It's a good business."

Indeed, while criminal syndicates are getting increasingly involved in the counterfeit trade, both in the United States and China, authorities say, it is ordinary folks like Gina and the shopkeepers she deals with who are the face of the counterfeit business in China.

Half-Hearted Enforcement

Guangzhou authorities occasionally raid the Baiyun market, including the day Reuters

journalists visited there. Shops, tipped off about the impending raid, dutifully closed their doors, though customers only had to knock to be let in surreptitiously.

"They are raiding now. I don't know when it will end. It's because of the Asian Games," said one shopkeeper. Guangzhou is hosting the games in November.

After a few minutes, the raid apparently ends with no arrests made. Shop owners slide off their stools, fling open their glass doors and stand outside beaming and beckoning at customers again. They don't cater to tourists, but sell in bulk to wholesalers such as Gina. Each shop claimed to have a factory backing it.

In the basement of the stores are the shippers, who expertly pack and label the items so they sail through customs.

"If you want to send to France, it is a bit hard, because they check thoroughly. But sending via UPS has an 80 percent success rate," said one such shipper named Chen, who like the others interviewed in China for this story, declined to give his full name to avoid getting in trouble.

They will also route shipments through ports in the Middle East or Africa to avoid detection by customs in the European Union and the United States, he said.

Sitting on a small stool in a Baiyun shop, Gary, a 30-year-old Congolese, represents another branch of the industry — the intermediary. Speaking Mandarin to a shopkeeper and switching to French for his three African clients, he was trying to put together a deal on counterfeit Italian Miu Miu bags.

He came to China two years ago to study, but has made helping European and African clients buy fakes a thriving side business.

"I buy a lot and pack them in boxes of 10. Then I ship them to England and drive [them] into France, and they get picked up," Gary whispered in Mandarin. "It's a sensitive business," he said with his baseball cap shoved low on his head.

Similarly, Nana, 30, a native of Moscow, has lived in Guangzhou for four years. She was buying fake Tommy Hilfiger and Gucci clothes in Baiyung, which she planned to supply to 20 web sites in Russia.

Few if any foreigners are ever caught or prosecuted, and not many locals, either. China's counterfeit industry employs millions of workers, distributors and shop clerks across the nation, one reason why authorities have often been half-hearted in their enforcement measures.

But in October the government said it would soon launch a six-month crackdown on piracy and trademark infringement. The illicit traders "upset the market's normal order, impair the competitive strength and innovation of businesses, and hurt China's image abroad," the State Council, or Cabinet, said in a statement.

In the second half of last year, China's customs department seized 2.6 million counterfeit items from the country's postal and express consignments, Meng Yang, a director general in the customs department, said in a speech in Shanghai in September.

That's probably just a small fraction of the total trade in China, experts said, given the amount of fake merchandise from China seized abroad.

New Anti-Pirate Weapons

Back in Washington, I handed over the fake Louis Vuitton bag to the National Intellectual Property Rights Coordination Center. Federal agents, standing in front of a display case of counterfeit shampoo, condoms, medicine and other products seized over the years, good-naturedly accept the bag. They said it was much better quality than the ones they had brought in to show me.

The new center is a partnership among a dozen federal law enforcement agencies and the Mexican government. Richard Halverson, its chief for outreach and training, said U.S. customs officials and postal inspectors have been on the lookout for counterfeit goods from China, but can't catch every one.

The money to be made selling counterfeit goods is so good "we have seen organized crime groups, what you would consider drug trafficking groups, actually move away from some of those other crimes into the counterfeit goods trade because it is a high-profit, low-risk cash business — the prime things that criminals are looking for," Halverson said.

It may seem harmless enough, but a consumer surfing the web looking for a good deal on prescription drugs, for example, needs to beware. "You may be looking at what you believe to be a Canadian pharmacy, when in fact the drugs are being manufactured in India, the site is being run out of China, and your payment is going to another group in Russia," Halverson said.

In the 2009 budget year, U.S. customs agents and other officials made 14,481 seizures valued at \$260.7 million. When the final tally for the 2010 budget year is in, the figures will be much higher, Halverson said, noting that in just one operation U.S. agents in Baltimore working with London police seized eight containers of counterfeit shoes and handbags.

One recent IPR Center enforcement action, called "Operation in Our Sites," seized the domain names of seven web sites that allow visitors to stream or illegally download first-run movies, often just within hours of hitting the theaters.

Halverson took me to the IPR's operations room, where undercover agents search out web sites and plot ways to disrupt them. The room, with a huge video monitor on the far wall, also functions as a command post to run operations in the field.

"Our undercover operation here is just Internet-based. We don't have any face-to-face meetings," one agent said, explaining that they use "undercover computers" that allow them to trawl for counterfeiters without being identified.

After making a buy and confirming it is a counterfeit item, ICE agents will get a court order to seize the site's domain name and shut it down. But a longer criminal investigation is required to seize assets and put people in jail, the agent said.

Many owners of the domain names, such as Ericwhy, are overseas, making it difficult for U.S.

law enforcement to go after them. So often the most viable option is to close the site, another agent said.

Organized Crime Links

While it often seems that the counterfeit industry in China is mostly mom-and-pop, Washington sees the problems caused by fake goods as much bigger and more sinister than many imagine. "Counterfeiting and piracy is increasingly the focus of organized crime," said Morton, who heads ICE, the U.S. government's second-largest criminal investigation agency after the FBI.

"There's a lot of money in it, and you need a fairly sophisticated operation to pull it off. You need an ability to manufacture goods on a grand scale, you need a shipping network," Morton said in an interview in his office at ICE headquarters with a view of the Washington Monument and Potomac River.

"It literally affects every segment of American manufacturing and business," he continued, ticking off examples: "Counterfeit aircraft engine parts, counterfeit ball bearings for machines, counterfeit pharmaceuticals, counterfeit electronics."

The Internet has made it much easier for unscrupulous companies to sell fake or pirated goods. "You don't have to go to the corner of Fourth and Main to buy your fake Gucci handbag. You can order it over the Internet," Morton said.

Counterfeit products are also increasingly sophisticated and hard to distinguish from the real thing. In the old days, Morton said, everyone knew an item was a knock-off because it looked like a cheaper version of the original. But now, counterfeiters want to mimic the item as closely as possible to get higher prices and profits.

One new tool Washington hopes will help in the international fight is a proposed Anti-Counterfeiting Trade Agreement. Negotiators from the United States, the 27 nations of the European Union, Japan, Australia, Canada, South Korea, Mexico, Morocco, Singapore and Switzerland reached a tentative agreement in late September on the pact, which has been years in the making.

With support from groups such as the U.S. Chamber of Commerce and the Business Software Alliance, Congress is preparing legislation giving the U.S. Justice Department broad new powers to take down "rogue web sites," both at home and overseas.

"Sites like this one [www.ericwhy.com] are stealing the ideas and designs of legitimate, hardworking manufacturers to line the pockets of foreign criminal networks," said Rob Calia, senior director for counterfeiting and piracy at the U.S. chamber. "It's theft, plain and simple, and it's hurting our economy."

Internet Chat Rooms

It is on the Internet where counterfeit traders in China are finding a growing market, not to mention a safer place from which to deal. Chat rooms on sites such as www.thefashionspot.com are dedicated solely to finding suppliers and discussing bags. Other

sites such as Replica Underground offer members direct links to Chinese suppliers.

The consensus in the chat rooms is that the best quality fakes that can be bought from web sites come from Jacky, Catty and Joy — all pseudonyms.

Joy, 30, started selling fake Louis Vuittons as a sideline. Having spent a couple of years overseas, she banter with potential customers on her web site in flawless English. But behind the cheery facade is a troubled pirate.

"I am worried every day about being caught," Joy said in an e-mail interview. "The old Chinese saying goes: It's a dagger hanging on top of my heart. I've been trying to get out of the business since day one. I have tried everything. I even started my own brand, but nothing sells like replicas," she said.

Catty, who has been in the business of making "mirror-image" Chanel bags for six years, sells 2,000 to 3,000 bags a month to customers all over the world, for about \$100 each. Under Chinese law, that size of operation surpasses the threshold required to begin a criminal investigation, as opposed to a civil fine.

"Yes, I am so afraid of getting caught, but in China many, many people do this job. You can find many people doing my job on iOffer, Taobao and eBay," Catty said in an e-mail interview, referring to online auction sites.

The online merchandising trend, and shipping via small parcels, has made it increasingly hard for authorities to track the extent of the problem.

"Traditionally, we'd find a few containers every year, and they're nice figures to report," said John Taylor, an official with the European Union IPR enforcement unit. "But now there are less containers identified, and customs is working almost twice as hard to find as many products because of the growing trend for consumers to buy items over the Internet," he said.

Ebay, which has lost lawsuits in France to Louis Vuitton for not policing the site for fakes actively enough, said the firm has made an increased effort of late.

"We're serious about it. We vet Chinese sellers. If China is going to connect with the rest of the world, China has to confront piracy and counterfeits themselves," eBay chief executive John Donahue said in an interview.

Jack Chang is a veteran campaigner against counterfeit goods. As chairman of China's leading intellectual property protection group, the Quality Brands Protection Committee, he has worked with the Chinese government to make enforcement a priority.

China's dual system for counterfeit goods enforcement, with duties shared between China's administrative authorities and its police, provides enforcement options for brand owners. But it also forms one of the biggest problems in cracking down on the illicit industry.

Under Chinese law, a counterfeit case is not subject to criminal investigation unless it surpasses a certain value or volume threshold. However, unless an investigation is made, it is nearly impossible to know the magnitude of the counterfeiting. Without evidence to prove that the threshold is met, the police cannot start the investigation. "It's a which-came-first

situation: the chicken or the egg," Chang said.

Adding to the problem are the sheer numbers of mom-and-pop stores selling these goods.

"It's a never-ending story. Every time you hit one, another one pops up somewhere else, and you have to hit it again. So it's tough," said Jean Cassegrain, chief executive of French luxury house Longchamp.

Frustration With China

On Capitol Hill, frustration with China's pirates is adding to rising tensions with China over a range of issues, including the trade deficit and other unfair trade practices they say are taking away American jobs.

Senator Byron Dorgan, a Democrat from North Dakota, was conducting a recent hearing on pirated movies, as chairman of a watchdog panel set up after China and the United States normalized trade ties in 2000.

Many thought that China's entry into the World Trade Organization would create a boom for U.S. exports. Instead, the trade gap has gotten worse year after year, with the deficit on track this year to reach about \$250 billion.

Dorgan is grilling Greg Frazier, a vice president at the Motion Picture Association of America, about how Washington ended up agreeing to limit the number of foreign films that can be shown in China to just 20 a year under the WTO pact.

The U.S. movie industry believes that the quota has fueled the huge market for pirated DVDs and illegal Internet downloads. "Here is the paradox: There's an abundance of American movies in China, but most of them are pirated," Frazier told the hearing.

China's policing of the Internet for pornography and political content raises questions on why it can't do the same for sites that offer pirated or counterfeit goods, legislators said.

"We know the Chinese government could be doing far more — far, far more — to protect intellectual property rights," Representative Sander Levin, a Democrat from Detroit, told the hearing. "There's a widening chasm between what we hear from the Chinese government about IPR protection and what we know to be true."

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