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# Chapter 431: Reinforcing California's Non-Tolerance to Trademark Counterfeiting

*Mani Partheesh*

## *Code Section Affected*

Penal Code § 350 (amended).

AB 1394 (Krekorian); 2008 STAT. Ch. 431.

## I. INTRODUCTION

In 1989, a Norwegian shipping company rewarded fifty of its employees with a free trip to Germany on a chartered plane.<sup>1</sup> The Norwegian plane, carrying the fifty employees and five crew members, crashed near the North Sea en route to Germany.<sup>2</sup> Sadly, none of the fifty-five people on board the aircraft survived.<sup>3</sup> It was the worst air crash in Norwegian history.<sup>4</sup> Investigators later revealed that substandard counterfeit bolts were used in the aircraft's tail assembly that held the tail to the rest of the aircraft's body.<sup>5</sup> The investigators concluded that the aircraft's tail fell off mid-air due to the counterfeit bolts, causing the crash.<sup>6</sup> Stories like this, involving counterfeit products, are not so rare, and may actually serve as examples of the threat counterfeit products pose to public health and safety.<sup>7</sup>

In response to such unfortunate circumstances, California Penal Code section 350 made it a crime for a person to willfully manufacture, intentionally sell, or knowingly possess counterfeit products.<sup>8</sup> Chapter 431 aims to improve section 350's effectiveness and deterrent value.<sup>9</sup>

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1. *55 Killed in Crash of Norwegian Plane None Aboard Survive as Craft Plunges into Sea Near Denmark*, L.A. TIMES, Sept. 9, 1989, at A1 [hereinafter *Norwegian Plane Crash*].

2. *Id.*

3. *Id.*

4. *Id.*

5. *Special Report: Imitating Property Is Theft - Counterfeiting*, ECONOMIST, May 17, 2003, at 70 (on file with the *McGeorge Law Review*).

6. *Id.*

7. See David J. Goldstone & Peter J. Toren, *The Criminalization of Trademark Counterfeiting*, 31 CONN. L. REV. 1, 4 (1998) (providing examples illustrating that trademark counterfeiting poses a danger to public health and safety).

8. CAL. PENAL CODE § 350(a) (West 1999).

9. See SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394, at J (June 16, 2008) (discussing the various provisions in Chapter 431).

## II. LEGAL BACKGROUND

### A. Harmful Effects of Trademark Counterfeiting

Trademarks and service marks are vital ingredients of modern society.<sup>10</sup> To a consumer, these marks provide an instant source of reliable information about the merits and durability of products in the market.<sup>11</sup> For a manufacturer, the goodwill and brand equity created by trademarks ensures continued customer loyalty.<sup>12</sup> Trademark counterfeiters negatively affect both the consumers and manufacturers: consumers are defrauded because they take home a product of inferior value;<sup>13</sup> manufacturers suffer a loss of sales and reputation.<sup>14</sup>

Additionally, there have been several instances of products with counterfeited trademarks that create a threat to public health and safety.<sup>15</sup> Examples include food products that do not meet FDA standards,<sup>16</sup> bath products that are contaminated with harmful bacteria,<sup>17</sup> children's toys that do not comply with consumer safety standards,<sup>18</sup> and automotive parts that present safety hazards.<sup>19</sup>

In *Textron v. Aviation, Sales*, the defendants manufactured and distributed helicopter parts with counterfeited trademarks.<sup>20</sup> These parts were used in critical components of helicopters' navigation instruments, and were later found to be "defective, [and] not airworthy."<sup>21</sup> Several helicopters crashed during takeoff and landing, resulting in injuries and the death of several people, causing the helicopters' manufacturers to recall the entire fleet of helicopters.<sup>22</sup> The United States District Court for the Central District of California found that the failure of

10. Goldstone & Toren, *supra* note 7, at 4. "A trademark can be a word, logo, slogan, package, design or other source indicator, or a combination of them." International Trademark Association, Statement on Trademark Counterfeiting, Feb. 12, 2002, [http://www.inta.org/index.php?option=com\\_content&task=view&id=629&Itemid=152&getcontent=3](http://www.inta.org/index.php?option=com_content&task=view&id=629&Itemid=152&getcontent=3) [hereinafter INTA] (on file with the *McGeorge Law Review*). Trademarks are imperative marketing tools used by companies to "distinguish their products and services from those of their competitors." *Id.* Equally important is a trademark's ability to "convey to consumers a message of quality, consistency, safety, and predictability in an easy-to-understand form, answering basic, but critical questions like 'Who am I?' and 'Where do I come from?' and 'What can I do for you?'" *Id.*

11. Goldstone & Toren, *supra* note 7, at 4.

12. *Id.*

13. *Id.*

14. *Id.*

15. *See id.* at 5 (providing a list of examples where trademark counterfeiting has resulted in public health and safety issues).

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. Civ. 77-1317 (C.D. Cal. 1980), *cited in* S. REP. NO. 98-526, at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3627, 3630-31.

21. *Id.*

22. *Id.*

the defendant's parts "result[ed] in the in-flight loss of control of the helicopters."<sup>23</sup> Additionally, the court found that the inferior parts with the counterfeited trademarks resulted in the tragic loss of human life "as a result of the failure of [the] parts manufactured and sold by the defendants."<sup>24</sup>

### B. Existing Federal Law

Congress has long realized the need to treat the use of counterfeit trademarks as more than just a civil wrong.<sup>25</sup> As early as 1876, Congress included penal statutes against trademark counterfeiting as part of the Federal Trademark Registration Act (FTRA).<sup>26</sup> However, the Supreme Court soon held that the FTRA was unconstitutional because it exceeded the federal government's interstate commerce power.<sup>27</sup>

It took more than a century for Congress to enact legislation that made trademark counterfeiting a federal crime.<sup>28</sup> In 1984, Congress enacted the Trademark Counterfeiting Act (TCA) to criminalize trafficking in goods and services bearing a counterfeit mark.<sup>29</sup> Under the TCA, it is a federal crime to intentionally or knowingly traffic goods or services that use a counterfeit mark.<sup>30</sup> A counterfeit mark is defined as "a spurious mark . . . that is identical with, or substantially indistinguishable from, a [registered mark] . . . the use of which is likely to cause confusion, to cause mistake, or to deceive."<sup>31</sup> The TCA also provides that a court shall order the counterfeiter to pay restitution to the owner of the mark or to any victim.<sup>32</sup>

### C. Existing California Law

Section 350 of the California Penal Code defines a counterfeit mark as a spurious mark that is "identical with, or confusingly similar to, a registered [trade]mark."<sup>33</sup> Section 359 provides that the spurious marks include any mark

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23. *Id.*

24. *Id.*

25. Craig O. Correll, *Using Criminal Sanctions to Combat Trademark Counterfeiting*, 14 AIPLA Q.J. 278, 279 (1986).

26. *Id.*

27. See *In re Trade-Mark Cases*, 100 U.S. 82, 98-99 (1879) (holding that the Federal Trademark Registration Act of 1870 is unconstitutional); BLACK'S LAW DICTIONARY 285 (8th ed. 2004) (defining interstate commerce as "[t]rade and other business activities between those located in different states; esp., traffic in goods and travel of people between states").

28. See Correll, *supra* note 25, at 279 (explaining how the FTRA was held unconstitutional in 1879 and a new federal law criminalizing trademark counterfeiting was not enacted until 1984).

29. *Id.* at 280.

30. 18 U.S.C. § 2320(a) (2006).

31. *Id.* § 2320(e)(1)(A)(ii), (iv).

32. *Id.* § 2320(b)(4).

33. CAL. PENAL CODE § 350(e)(2) (West 1999).

that is used in connection with any “identical articles containing identical marks.”<sup>34</sup> Existing law also makes it a crime for a person to intentionally sell, willfully manufacture, or knowingly possess for sale any counterfeit products.<sup>35</sup> This is similar to the TCA, which places an intent requirement in the trafficking of counterfeit products.<sup>36</sup> However, existing law cannot be enforced against a person who adopted and “lawfully” used the mark before the date the complaining party registered the mark.<sup>37</sup>

Similar to the TCA, existing law allows a court to order the seizure of “all goods, articles, or other matter bearing the marks, . . . all means of making the marks, and any and all electrical, mechanical, or other devices for manufacturing, reproducing, transporting, or assembling these marks.”<sup>38</sup>

### III. CHAPTER 431

Chapter 431 expands the definition of a “counterfeit mark” to include unassembled components, such as “labels, patches, fabric, stickers, wrappers, badges, emblems, medallions, charms, boxes, containers, cans, cases, hangtags, documentation, or packaging, or any other components of any type or nature that are designed, marketed, or otherwise intended to be used on or in connection with any articles.”<sup>39</sup>

In addition, Chapter 431 adds business entities to the list of those liable under the provisions of section 350.<sup>40</sup> A “business entity” includes corporations, limited liability companies (LLCs), and partnerships, but does not include sole proprietorships.<sup>41</sup> However, Chapter 431 provides that section 350 cannot be enforced against a person or business entity that engages in fair use<sup>42</sup> of the mark.<sup>43</sup>

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34. *Id.*

35. *Id.* § 350(a).

36. 18 U.S.C. § 2320(a).

37. CAL. PENAL CODE § 350(f).

38. *Id.* § 350(d).

39. *Id.* § 350(e)(3) (amended by Chapter 431).

40. *Id.* § 350(a) (amended by Chapter 431).

41. *Id.* § 350(e)(2) (amended by Chapter 431).

42. *See* CAL. BUS. & PROF. CODE § 14247(b) (West 2008) (explaining that the fair use of a trademark includes “[a]dvertising or promotion that permits consumers to compare goods or services . . . [and the i]dentifying and parodying, criticizing, or commenting upon the famous mark owner or the goods or services of the famous mark owner”).

43. CAL. PENAL CODE § 350(h) (amended by Chapter 431).

#### IV. ANALYSIS OF CHAPTER 431

##### A. *Deficiencies in Section 350 of the California Penal Code*

According to Chapter 431's author, Assembly Member Krekorian, "[u]nder existing law, California's consumers are not adequately protected from the traffic of counterfeit goods."<sup>44</sup> Krekorian further indicated that "[w]ithout adequate penalties to shut down the organized criminal operations that thrive on the sale of creative works and goods that are not their own, law enforcement officers will not be able to prevent the destruction of legitimate industries in California that rely on their marks for economic success."<sup>45</sup>

Chapter 431 sought to rectify a number of deficiencies in existing law. Specifically, existing law: (1) does not clearly define the meaning of "business entities," thus allowing LLCs and other commercial entities to escape a higher fine earmarked for business entities;<sup>46</sup> (2) is "unclear on whether separate fake components . . . are illegal counterfeit goods unless already assembled";<sup>47</sup> and (3) does not allow persons or business entities that engage in fair use of the mark to escape liability.<sup>48</sup>

##### B. *Chapter 431 Addresses the Deficiencies in Existing Law*

###### 1. *Meaning of "Business Entities"*

To prevent LLCs and other commercial entities from escaping enhanced fines, Chapter 431 provides that "a business entity" shall be liable.<sup>49</sup> Under Chapter 431, a business entity "includes, but is not limited to, a corporation, a limited liability company, or [a] partnership."<sup>50</sup> Chapter 431 does not subject sole proprietorships to the same enhanced fines as other larger commercial entities, thus preserving the "distinction in the fine structure between individuals and commercial entities."<sup>51</sup> The effect of this differentiation is that a person who runs a small boutique will not be forced to pay the same fine as a company that manufactures thousands of counterfeit items.<sup>52</sup> In addition, Chapter 431 ensures that LLCs will be subject to the same enhanced fines as corporations.<sup>53</sup>

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44. SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394, at N (June 16, 2008).

45. *Id.*

46. *Id.* at R.

47. Letter from Kyla Christoffersen, Policy Advocate, Cal. Chamber of Commerce, to Members of the Cal. State Senate (July 14, 2008) [hereinafter Christoffersen Letter] (on file with the *McGeorge Law Review*).

48. *See generally* CAL. PENAL CODE § 350 (failing to provide a fair use defense).

49. SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394, at R (June 16, 2008).

50. CAL. PENAL CODE § 350(e)(2) (amended by Chapter 431).

51. SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394, at R (June 16, 2008).

52. *Id.* at R-T.

53. *See* CAL. PENAL CODE § 350(e)(2) (amended by Chapter 431) (providing that limited liability

## 2. *Unassembled Components*

Prior to Chapter 431, the law did not specify whether unassembled components that carry counterfeit marks carried the same protection as assembled products.<sup>54</sup> For example, prior law was “unclear on whether separate fake components, e.g., fake computers and the fake brand name labels that are to be affixed to them, are illegal counterfeit goods unless already assembled.”<sup>55</sup> Chapter 431 clarifies this uncertainty by expressly providing that unassembled goods are illegal goods, thus ensuring that unassembled components are also covered under the provisions of section 350.<sup>56</sup>

## 3. *“Fair Use” Defense*

Chapter 431 provides that a person who engages in “fair use” of a trademark is not subject to criminal prosecution.<sup>57</sup> Federal law also has a similar provision, but restricts the fair use defense to one of three categories where the defendant can prove that the mark was the defendant’s own name, descriptive of the defendant’s goods or services, or descriptive of the geographic origin of defendant’s goods or services.<sup>58</sup> Chapter 431, however, extends the fair use defense to the “[a]dvertising or promotion that permits consumers to compare goods or services[,] [i]dentifying and parodying, criticizing, or commenting upon the famous mark owner or the goods or services of the famous mark owner.”<sup>59</sup> Moreover, Chapter 431 allows a defendant to invoke the fair use defense in both criminal and civil actions involving trademark counterfeiting.<sup>60</sup>

## 4. *Support for Chapter 431*

Chapter 431 had widespread recognition and support from a variety of political and business organizations.<sup>61</sup> In enacting Chapter 431, neither the State

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companies are considered business entities).

54. See Christoffersen Letter, *supra* note 47 (“[S]tate law is unclear on whether separate fake components . . . are illegal counterfeit goods.”).

55. *Id.*

56. CAL. PENAL CODE § 350(e)(3) (amended by Chapter 431).

57. *Id.* § 350(h) (amended by Chapter 431).

58. See 15 U.S.C. § 1115(b)(4) (2006) (stating specifically that the statute provides as a defense “[t]hat the use of the name, term, or device charged to be an infringement is a use, otherwise than as a mark, of the party’s individual name in his own business, or of the individual name of anyone in privity with such party, or of a term or device which is descriptive of and used fairly and in good faith only to describe the goods or services of such party, or their geographic origin”).

59. CAL. BUS. & PROF. CODE § 14247(b) (West 2008).

60. SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394, at J (June 16, 2008).

61. See *id.* at A (“Support [for Chapter 431]: California Grocers Association; California Retailers Association; International AntiCounterfeiting Coalition; United States Chamber of Commerce; California Alliance for Consumer Protection; Valley Industry and Commerce Association.”).

Assembly nor the State Senate received any opposition.<sup>62</sup> The California Retailers Association, arguing in support of Chapter 431, indicated that “[c]ounterfeiting of trademarked products has far-reaching negative consequences, impacting numerous California industries” and that Chapter 431 would bring “California law into greater conformity with federal penalties for counterfeiting.”<sup>63</sup> The California Chamber of Commerce noted that Chapter 431 ensures that “California’s anti-counterfeiting standards are strong and effective [and] will provide greater protections for trademark owners and consumers and will help prevent significant revenue losses sustained by California businesses, our state, and our local governments because of counterfeiting.”<sup>64</sup> Supporters are also confident that Chapter 431 “will assist in deterring individuals from becoming involved in counterfeiting activity because it will no longer be seen as a crime that is worth the risk.”<sup>65</sup>

## V. CONCLUSION

California’s decision to treat the misuse of trademarks as a criminal matter is consistent with the nation’s recognition of “the ever increasing value of intellectual property to th[e] nation’s economic wellbeing, and of the damage to the public caused by mis-marked goods and services.”<sup>66</sup> The new criminal liability has come as “a rude awakening for several counterfeiters who have cooled their heels in county jails as a direct result of [California’s] push for prosecution.”<sup>67</sup> The overall effect of section 350 is “to deter future counterfeiters, thereby protecting the public from fraud and the trademark owner’s intellectual property from misuse.”<sup>68</sup> Chapter 431 enhances the deterrent value of section 350 by extending its coverage, and further reinforces the zero tolerance attitude California takes toward trademark counterfeiters.<sup>69</sup> By enhancing the deterrent value of section 350, Chapter 431 will also reduce the likelihood of tragic accidents like the Norwegian plane crash that result from products with counterfeited trademarks.<sup>70</sup>

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62. *See id.* (indicating that there is no known opposition to the enactment of Chapter 431).

63. *Id.* at T.

64. Christoffersen Letter, *supra* note 47.

65. Garden Grove Chamber of Commerce, Chamber Supports AB1394 (Mar. 26, 2008) (on file with the *McGeorge Law Review*).

66. Goldstone & Toren, *supra* note 7, at 35.

67. Correll, *supra* note 25, at 288.

68. *Id.*

69. *See generally* SENATE COMMITTEE ON PUBLIC SAFETY, COMMITTEE ANALYSIS OF AB 1394 (June 16, 2008) (discussing the various amendments proposed in Chapter 431 and the advantages of the proposed amendments to section 350).

70. *Norwegian Plane Crash*, *supra* note 1.



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