

# **Legal Issues and Resolving Disputes With Counterfeit Components**

Event:

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Presenter:

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I. **Introduction**

Counterfeit/Defective components have become common in the electronic components industry. It appears that this fact will continue to be a factor for the foreseeable future. Therefore, it is important for those who purchase and sell electronic components to become increasingly more knowledgeable about applicable laws and the manner in which they are applied. This topic is broad and would justify at least a full day of presentation. However, with our limited time here today, I will touch upon a few important concepts that you can take with you and discuss further with your colleagues and legal counsel.

Mainly, I will give a brief overview of a few statutes that affect electronic component transactions at the contract formation level and at the point of entry into the United States. Specifically, I am referring to the Uniform Commercial Code, Article 2, applied to sales transactions, and United States statutes dealing with customs seizure issues. Much of the UCC material will be brought out through the use of a case study which follows this introduction.

## **II. Article 2 of the Uniform Commercial Code**

### **A. Case Study**

Mr. Independent received a requisition from Ms. OEM for 5,000 XR50 parts. Mr. Independent searched for availability of this part. Based upon such availability, Mr. Independent quoted Ms. OEM a price and quantity in writing. Ms. OEM sent a purchase order by e-mail to Mr. Independent which referenced her terms and conditions of purchase. Mr. Independent sent by fax a purchase order to supplier for the parts which referenced his terms and conditions of purchase. Supplier faxed its acceptance of Mr. Independent's offer and referenced its terms and conditions of sale which were different than Mr. Independent's. Mr. Independent faxed his acceptance of Ms. OEM's offer and referenced his sales terms and conditions which differed from Ms. OEM's terms of purchase. All of the above terms and conditions differed from the U.C.C.

Supplier shipped half of the parts to Mr. Independent. Mr. Independent examined the parts and shipped them to Ms. OEM. Ms. OEM put the parts in her warehouse without examining them. Three months later, supplier shipped the remaining half of the order to Mr. Independent who did not examine the parts and shipped them to Ms. OEM. Ms. OEM received the parts, and together with the previous shipment, incorporated the parts into a product which failed. Ms. OEM notified Mr. Independent immediately. Mr. Independent then notified supplier. It is determined that the parts are counterfeit/defective. What rights do the parties have?

**B. Acceptance/Rejection/Revocation**

**1. Acceptance**

Acceptance of goods occurs when:

- a. The buyer, after reasonable opportunity to inspect them, indicates to the seller that they conform or that she will keep them in spite of their nonconformance;
- b. The buyer fails to reject them within a reasonable time after tender or delivery of the goods or fails to seasonably notify the seller of her rejection; or
- c. The buyer does anything inconsistent with the seller's ownership.

**2. Rejection Prior to Acceptance**

- a. Right of Rejection Generally

When goods that do not conform to the contract are tendered to a buyer, the buyer may either keep them (and sue for damages) or, under some circumstances, reject the goods and either cancel the contract or sue.

1) Right of Rejection in Single Delivery Contracts

In single delivery contracts (all goods to be delivered at once), if the goods or the tender fail to conform, the buyer may reject all, accept all, or accept any commercial units and reject the rest.

2) Right of Rejection in Installment Contracts

In an installment contract (goods are delivered in installments), the buyer can reject an installment only if the nonconformity substantially impairs the value of that installment and cannot be cured. The whole contract is breached if the nonconformity substantially impairs the value of the entire contract.

b. Formal Requirements for Rejection

Rejection must be within a reasonable time after delivery or tender and before acceptance. The buyer must seasonably notify the seller. If the buyer fails to state that the goods have a particular defect ascertainable by reasonable inspection, he cannot rely on that defect to justify rejection or show the seller's breach if: (i) the seller could have cured the defect if he had been told about it; or (ii) in contracts between merchants the seller has, after rejection, made a request in writing for a full and final written statement of all defects upon which the buyer proposes to rely.

c. Buyer's Responsibility for Goods After Rejection

After rejection of goods in her physical possession, the buyer has an obligation to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them or give instructions as to what to do. If a seller gives no instructions within a reasonable time after notification of rejection, the buyer may reship the goods to the seller, store them for the seller's account, or resell them for the seller's account. The buyer has a security interest in rejected goods in her possession for any part of the price already paid and for expenses reasonably incurred in connection with handling the goods after rejection.

d. **Seller's Right to Cure**

Where a buyer has rejected goods because of defects, the seller may within the time originally provided for performance "cure" by:

- \* Giving reasonable notice of intention to cure; and
- \* Making a new tender of conforming goods, which the buyer must then accept.

1) **Limited Right to Cure Beyond Original Contract Time**

There is one circumstance where a seller is allowed to cure after the original time for performance has passed: If the seller sends the buyer nonconforming goods that he reasonably believes will be acceptable to the buyer, but the buyer rejects, the seller will get a reasonable time to cure, even though the original time for performance has passed.

2) **Seller's Right to Cure in Installment Contracts**

A defective shipment in an installment contract cannot be rejected if the defect can be cured.

**3. Revocation of Acceptance**

The time of acceptance is important because it terminates the buyer's power to reject and obligates her to pay the price less any damages because of the seller's breach. However, the buyer may revoke her acceptance of goods if the defect substantially impairs their

value to her and: (i) she accepted them on the reasonable belief that the defect would be cured and it has not been; or (ii) she accepted them because of the difficulty of discovering defects or because of the seller's assurance that the goods conformed to the contract. Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the defect and before any substantial change in the goods not caused by their own defects. A proper revocation of acceptance has the effect of rejection.

**C. Other Claims/Damages of Buyer**

**1. Buyer's Right to Replevy Identified Goods**

In some circumstances, a buyer will want to replevy (obtain) goods in the seller's possession. The buyer may replevy identified, undelivered goods from the seller if the buyer has tendered full payment and made at least part payment and either: (i) the seller becomes insolvent within 10 days after receiving the buyer's first payment, or (ii) the goods were purchased for personal, family, or household purposes. In other cases, where the seller has failed to deliver identified goods, the buyer may replevy them from the seller if the buyer is unable to secure substitute goods.

**2. Buyer's Right to Specific Performance**

The court may order specific performance where the goods are unique or in other proper circumstances (inability to cover) even if the goods have not been identified to the contract.

**3. Buyer's Damages**

a. For Nondelivery or upon Rejection or Revocation of Acceptance

The buyer's basic remedy where the seller does not deliver or the buyer properly rejects or revokes acceptance of tendered goods is the difference between the contract price and either the market price or the cost of buying replacement goods. (In either case, the buyer is also entitled to incidental and consequential damages less expenses saved as a result of the seller's breach.)

b. For Accepted Goods

If the buyer accepts goods that breach one of the seller's warranties, the buyer may recover as damages the difference between the value of the goods delivered and the value they would have had if they had conformed to the contract plus incidental and consequential damages. To recover damages for any defect as to accepted goods, the buyer must, within a reasonable time after he discovers or should have discovered the breach, notify the seller of the defect.

**D. SELLER'S REMEDIES**

**Seller's Damages**

The UCC provides three measures for damages for when the buyer wrongfully repudiates or refuses to accept conforming goods. The seller can:

1. Recover the difference between the market price and the contract price;
2. Resell the goods and recover the difference between the contract price and the resale price; or
3. Recover the difference between the list price and the cost to the seller. (Note that if the seller is a dealer, his costs would be the costs incurred in obtaining the goods from the manufacturer or another dealer, whereas if the seller is a manufacturer, his costs would be the costs of manufacturing the goods.)

**E. Different Terms and Conditions**

Under U.C.C. Article 2, any acceptance or written confirmation sent within a reasonable time that indicates an intention to enter into a contract will be effective as an acceptance, even if it states additional or different terms for the contract, unless the acceptance is expressly made conditional on assent to the acceptance terms.

**1. Acceptance Containing Additional Terms**

Additional terms in the acceptance will be included in the contract unless:

- a. They materially alter the original contract (an alteration is material if it changes either party's risk or available remedies);
- b. The offer expressly limits acceptance to the terms of the offer; or

c. The offeror has already objected to the particular terms, or objects within a reasonable time after notice of them is received.

**2. Acceptance Containing Different Terms**

There is a split of authority over whether terms in the acceptance that are different from (as opposed to additional to) the terms in the offer will become part of the contract. Some courts treat different terms like additional terms, and follow the test set out above in determining whether the terms should be part of the contract. Other courts follow the “knockout rule,” which states that conflicting terms in the offer and acceptance are knocked out of the contract because each party is assumed to object to the inclusion of such terms in the contract. Under the knockout rule, gaps left by knocked out terms are filled by the U.C.C.

**F. Real World Application**

Often an original offeror’s form will contain a clause objecting in advance to the addition of any new or inconsistent terms, and an offeree’s response often will propose new terms and state that the response is not an acceptance unless the original offeror expressly consents to the new terms. Such an exchange does not actually form a contract. Nevertheless, parties sometimes begin to perform anyway. In such a case, there is a contract consisting of all terms on which their writings agree, plus supplementary terms supplied by the U.C.C.

**III. Seizure by Customs Service – Title 19, United States Code**

U.S. Customs and Border Protection has full authority to assess penalties and liquidated damages claims, seize merchandise for violation of CBP laws or those of other federal agencies that are enforced by

CBP, remit forfeitures, mitigate penalties, decide petitions, and cancel claims. Seizures and penalties include the establishment of national policies and procedures for processing fines, penalties and forfeiture cases. The processing and disposition of these cases are strictly governed by laws, regulations, and mitigation guidelines designed to afford the claimant the greatest possible due process.

19 United States Code Section 1526 permits the Customs Service to seize any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle bears a trademark owned by a citizen of the United States, or by a United States corporation or association. The Customs Service need only have probable cause to suspect that the subject goods are either counterfeit, mismarked or infringe upon a United States trademark in order to have the right to seize these goods. Unless the trademark owner consents to the use of the counterfeit mark, the goods are deemed forfeited by the party seeking to export them into the United States.

Once the Customs Service has seized the subject property, it can dispose of the goods in one of four ways. After destroying the offending trademark from the seized products, Customs may dispose of the goods by: (1) delivering them to certain governmental agencies; (2) selling them at public auction; (3) giving them to a charitable organization; or (4) destroying them. Most importantly, Customs does not have the right after obliterating the counterfeit mark to deliver them to the party seeking to gain possession of the goods.

19 U.S.C. Section 1514 provides that if an importer disagrees with the Customs Service's decision to seize the goods in question, the importer must file in writing a protest with the appropriate customs officer. This written protest must set forth distinctly and specifically each decision as to which protest is made; each category of merchandise affected by each such decision as to which protest is made; and the nature of each objection and the reasons for each objection.

19 U.S.C. Section 1515 provides that the Custom Service has two years in which to make a decision as to the importer's protest. If the Customs Service determines that it made a mistake in seizing the subject goods, the Customs Service is responsible for reimbursing the importer for its damages, and any attorneys' fees and costs that it incurred in making the protest. However, it is unusual for the Customs Service to decide that it made a mistake leaving the complaining importer with only one available resource to whom to complain.

28 U.S.C. 1581 (a) provides that the Court of International Trade shall have exclusive jurisdiction of any civil action commenced to contest the denial of a protest made by a complaining importer. Federal Courts have been asked to assume jurisdiction over these types of cases, but they have refused due to the fact that Congress has been very specific in providing for the aforementioned forms of relief.