Special Report
Special Report
Special Report
Special Report

Reseller Liability on Will-Fit, Private Label and Counterfeit Products

Updated April 2010 as part of The AASA "Know Your Parts" Campaign www.kyp.aftermarketsuppliers.org

AASA Marketing Executives Council
April 2010

Reseller Liability on Will-Fit, Private Label and Counterfeit Products

Editor's Note: *The Automotive Aftermarket Suppliers Association (AASA) is committed to providing members and the motor vehicle parts supplier industry with the latest news and information regarding industry trends such as direct importing, counterfeiting and intellectual property rights violations. The following "Special Report" was originally published in February of 2008. It has been updated with more recent court cases and pertinent changes in the law as part of the AASA awareness campaign "Know Your Parts."*

Reseller beware – liability for counterfeiting, product safety issues and recalls could fall upon you in certain instances. A review of the recent court decisions in this area demonstrates that courts are finding distributors liable

1. for recalls or product safety issues resulting from private label (or "will–fit") products;
2. for actively participating in the counterfeiting scheme;
3. for being "willfully blind" to the counterfeit nature of the goods; and
4. for any harm resulting from the counterfeit goods under a product liability theory.

Each of these causes of action is discussed in detail below.

(1) Resellers may be responsible for the recall of a private label or will-fit product even if they were not involved in the manufacturing process.

Many resellers mistakenly believe that they will not be liable for any injuries resulting from a defective product because they are not involved in the manufacturing process of the product. Consequently, resellers have begun to supply private label or "will-fit" products in order to meet the price demands of their customers. Oftentimes they contract with a foreign manufacturer who has previously manufactured the product to meet certain specifications; thus, the reseller relies on this manufacturer and assumes it will meet these same specifications when developing the private label products. Unfortunately this is not the case as many private label manufacturers have to cut corners in order to meet the pricing demands.

Furthermore, with the history of unsafe products being imported into the U.S. including, tires, toys, and dog food, the public has started to demand that the National Highway Travel Safety Administrative ("NHTSA") and the Consumer Product Safety Commission ("CPSC") take a more active role in protecting the public. These agencies have stepped up to the challenge. In fact, NHTSA has recently begun to point its finger at the importing reseller when attributing liability for a product that does not meet U.S. standards. For example, NHTSA took action against the distributor of a tail light that did not meet the required safety standards. The assessed fines were in the range of $650,000.

A number of states also have started to hold the reseller liable for distribution of unsafe products. In 2007, then New York Governor Eliot Spitzer requested that the CPSC take action and draft legislation to address the problem. Spitzer asked that the legislation impose penalties against distributors, as well as the manufacturers, that are selling unsafe products; he also asked that the legislation require the packaging to identify the name of the distributor and manufacturer. This clearly demonstrates that the focus has shifted to hold accountable all parties involved in the distribution chain of a product.

(2) Resellers are liable if they actively participate in counterfeiting.

It should come as no surprise that a reseller may face liability for its active participation in trademark counterfeiting. "Active participation" can consist of activity ranging from the reseller actually applying labels on the counterfeit goods to a reseller that continues to sell product after receiving notice that it was counterfeit.

The former situation arose in a case involving batteries. The court found that the distributor was liable for trademark infringement when it placed the manufacturer's trademarks on counterfeit batteries and commingled them with genuine products. *Interstate Battery Sys. of Amer., Inc. v. Wright*, 811 F.Supp. 237 (N.D. Tex. 1993); *see also Shell Trademark Mgmt. BV v. Ray Thomas Petroleum Co.*, 642 F.Supp.2d 493 (W.D.N.C. 2009).

While liability for applying labels is foreseeable for any party, including distributors, it was more surprising when a court in North Carolina found a distributor liable for trademark infringement when it continued to sell previously purchased counterfeit software after discovering that the goods were not genuine. *Microsoft Corp. v. Computer Service & Repair, Inc.*, 312 F. Supp. 2d 779 (E.D.N.C. 2004); *see also Fendi Adele S.R.L. v. Burlington Coat Factory Warehouse Corp.*, 2010 WL 431509 at *10 (S.D.N.Y. Feb. 8, 2010). In this instance, the fact that the distributor merely failed to act was enough to hold it liable for counterfeiting.

The courts are not alone in challenging this issue. State and local officials, most notably, former New York Governor Eliot Spitzer, have also investigated and brought action against distributors for counterfeiting claims. In fact, as a result in investigations conducted by Spitzer, several parties were convicted for the distribution of counterfeit goods.

(3) Resellers are liable if they are "willfully blind" to the counterfeit nature of goods.

Much more surprising is the fact that resellers are now being found liable for the distribution of counterfeit products even if they did not have "actual" knowledge of the nature of the product. Instead courts have placed liability on distributors for counterfeiting if they "should have known" that that product was counterfeit. This means a reseller could be liable if it failed to inquire further because it was afraid of what the inquiry might reveal. Courts call this failure to inquire "willful blindness" and have found it to constitute the requisite "knowledge" to be liable for counterfeiting.

Koon Chun Hing Kee Soy & Sauce Factory, Ltd. v. Eastimpex, 2007 WL 328696 at *9 (N.D.Cal. Feb. 2, 2007); *Louis Vuitton S.A. v. Lee*, 875 F.2d 584, 590 (7th Cir. 1989).

The courts have examined a variety of evidence to determine whether the reseller has been willfully blind, including the following:

- Whether the purchase of the product was made by resellers from unauthorized dealers or on the secondary market. These purchases indicate willful blindness because they are outside the usual distribution network of the manufacturer. *Lorillard Tobacco Co., Inc. v. A&E Oil, Inc.*, 503 F.3d 588, 593 (7th Cir. 2007); *Fagan v. AmerisourceBergen Corp.*, 356 F.Supp.2d 198 (E.D.N.Y. 2004); *Tommy Hilfiger Licensing, Inc. v. Goody's Family Clothing, Inc.*, 2003 WL 22331254, at *19 (N.D. Ga. May 9, 2003); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077, 1089 (D. Md. 1995).

- Whether the goods were sold without authenticating documentation or with altered documentation. *Lorillard Tobacco Co., Inc. v. A&E Oil, Inc.*, 503 F.3d 588, 592 (7th Cir. 2007); *Gucci America, Inc. v. Duty Free Apparel, Ltd.*, 315 F.Supp. 2d 511, 516 (S.D.N.Y. 2004); *Tommy Hilfiger Licensing, Inc. v. Goody's Family Clothing, Inc.*, 2003 WL 22331254, at *19 (N.D. Ga. May 9, 2003).

- Whether the actual quality of the purchased goods differs dramatically from the quality expected by consumers. Purchases of high-end goods with poor workmanship or low quality materials are evidence of willful blindness. *Lorillard Tobacco Co., Inc. v. A&E Oil, Inc.*, 503 F.3d 588, 592 (7th Cir. 2007); *Louis Vuitton S.A. v. Lee*, 875 F.2d 584, 590 (7th Cir. 1989); *Levi Strauss & Co. v. Diaz*, 778 F.Supp. 1206, 1208 (S.D. Fla. 1991).

- Whether resellers have purchased goods at prices dramatically below the reasonable or suggested price for the goods. Uncharacteristically low prices for goods are often sufficient to provide evidence of willful blindness. *Koon Chun Hing Kee Soy & Sauce Factory, Ltd. v. Eastimpex*, 2007 WL 328696 at *9 (N.D.Cal. Feb. 2, 2007); *Louis Vuitton S.A. v. Lee*, 875 F.2d 584, 590 (7th Cir. 1989); *Microsoft Corp. v. Software Wholesale Club, Inc.*, 129 F.Supp. 2d 995, 1008 (S.D. Tex. 2000).

- Whether billing slips use mysterious or cryptic codes to describe the products purchased. This type of billing places a reseller on notice that unlawful activity may be occurring. *Microsoft Corp. v. Compusource Distributors, Inc.*, 115 F.Supp. 2d 800, 808 (E.D. Mich. 2000).

The above summary demonstrates that the courts are not hesitating to find a reseller liable if the evidence establishes that it should have known that the product at issue was not legitimate. In fact, in the Fagan case, a retailer and a distributor were held liable for the sale of counterfeit drugs primarily based on the fact that both parties could have purchased the legitimate product from the manufacturer but instead took the risk and bought the product on the secondary market. The court actually dismissed the

manufacturer from the case (even though it had originally manufactured the counterfeit drug) but found the distributor liable because it was in the best position to prevent the introduction of counterfeit goods into the stream of commerce. This is an important lesson for distributors as they should be certain that they are protecting themselves from liability and not simply ignoring a possible problem.

(4) Resellers can be liable under products liability theories for harm resulting from counterfeit goods.

Resellers may also be liable under products liability law on theories of negligence and strict liability for personal injuries and property damage when counterfeit products fail. Counterfeit products present a substantially higher risk than genuine products because counterfeiters are not overly concerned with product safety. For instance, counterfeiters will often include a label verifying the product safety specifications when the safety mechanism has, in fact, not been included in the counterfeit product. This obviously poses a threat to the safety of customers and can lead to expensive lawsuits and negative publicity for all who are involved.

Under U.S. law, however, the liability for the product failure does not solely lie with the manufacturer. In fact, resellers are vulnerable to liability under several legal theories. First, most state laws prescribe that all the parties in the chain of distribution for a product, including distributors, may be strictly liable for personal injuries or property damage resulting from a defective product. Thus, a distributor who has sold a counterfeit good in one of these jurisdictions can be liable – without having to establish any negligence or knowledge of the counterfeit goods – for merely selling the counterfeit product.

State law also maintains that resellers may be strictly liable when they market a product manufactured by another as if it were their own. This occurs either when a reseller may appear to be the actual manufacturer of the product or when the product is marketed in such a way through the use of trade names and trademarks that consumers believe the product was made especially for the distributor. *Restatement Second of Torts*, § 400, cmt. d. Thus, if the counterfeit product is marketed with the reseller's name, even if that reseller was not the manufacturer, the reseller may be found liable for the harm resulting from the use of the counterfeit good.

A review of the applicable case law demonstrates that American distributors have also been found liable for a defective part when the foreign manufacturer is located outside of the reach of American courts or is unknown. *Jennings v. AC Hydraulic A/S*, 383 F.3d 546, 550-52 (7th Cir. 2004); *Jennings v. Stertil-Koni*, 2003 WL 21180436 (S.D. Ind. Mar. 31, 2003); *Hutson v. Fehr Bros., Inc.*, 584 F.2d 833, 834-36 (8th Cir. 1978). Thus, because the U.S. court system may not be able to impose liability on a Chinese manufacturer, for example, it may attach some liability to the U.S. distributor for the harm resulting from the defective product.

Finally, if a distributor is merely acting as a conduit from a manufacturer to a retailer, the distributor may be liable only for known dangers. For example, if a distributor is

merely a shipping company that takes the product from Europe to the U.S., the distributor would only be found liable if it knew that the products that it was carrying were going to cause a danger to U.S. customers. The danger may be known through "actual knowledge", which means that the shipping company was told of the possible danger, or "constructive knowledge", which means that the distributor had reason to know of the danger due to certain information provided by the manufacturer. *American Law of Products Liability* § 5:23, at 48 (3d ed. 2001).

Conclusion

These trends demonstrate that resellers should be increasingly vigilant against the importation, distribution, and marketing of products that may be counterfeit. A lack of vigilance with respect to these products may result in a reseller being liable for both counterfeiting of goods and for personal injury and property damage resulting from the failure of counterfeit products. Likewise, a reseller may be found liable for will-fit and private label products even if they were not involved in the manufacturing process.

Prepared by:
Anthony V. Lupo
lupo.anthony@arentfox.com
202-857-6353

Sarah L. Bruno
bruno.sarah@arentfox.com
202-775-5760

Matthew R. Mills
mills.matt@arentfox.com
202-715-8582

Related AASA "Special Reports"

- Independent Aftermarket Image: Quality Does Matter
- Independent Repair Industry: Focus Group Findings on Buying Influences of Repair Professionals
- Direct Importing: Do the Risks Outweigh the Reward?

Contact Jack Cameron at ***jcameron@mema.org*** or 919-406-8856 for more information.

About AASA

AASA (***www.aftermarketsuppliers.org***) exclusively serves manufacturers of aftermarket components, tools and equipment, and related products. It is a recognized industry change agent – promoting a collaborative industry environment, providing a forum to address issues and serving as a valued resource for members. AASA is a market segment association of the Motor & Equipment Manufacturers Association (MEMA). "AASA, Leadership in the Global Automotive Aftermarket"