FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 9, Issue 3 August 2012

Department of Defense Cracks Down on Counterfeit Electronic Components

President Obama signed the National Defense Authorization Act for Fiscal Year 2012 (NDAA) into law on December 31, 2012. In addition to appropriating funds for military spending, the NDAA also creates new obligations for government contractors and subcontractors geared toward the detection and avoidance of counterfeit electronic parts. The NDAA was passed after a Senate Armed Services Committee memorandum was released stating that an investigation of the Department of Defense (DOD) supply chain had uncovered approximately 1,800 cases of suspect counterfeit electronic parts being identified by companies in the DOD supply chain, with the total number of suspect parts exceeding one million. The memorandum went on to state that one of the primary contributing factors to this problem is the fact that defense projects tend to have long life cycles, whereas parts in the electronics industry routinely become obsolete within 18 months after they enter the market. Once they become obsolete, the supply for these parts drops, and contractors often have to turn to brokers and other secondary-market sources to find needed parts. Counterfeit parts have long been a problem in these secondhand markets. The memorandum went on to state that counterfeit parts pose a risk to national security, the reliability of American defense systems, and the safety of military personnel, as well as damaging the American economy and taking away American jobs.

To combat this problem, Congress drafted Section 818 of the NDAA. That section includes requirements for both the DOD and defense contractors. As an initial step, Section 818 requires the Secretary of Defense to assess the DOD policies and systems for detecting and avoiding counterfeit electronic parts. The deadline to complete that assessment was June 28, 2012. After that assessment is complete, the DOD is required to implement measures internally in order to improve its own policies and systems to detect and avoid the use of counterfeit parts.

By September 26, 2012, the Secretary of Defense must revise the Defense Federal Acquisition Regulation Supplement (DFARS) to include new requirements applicable to covered contractors who supply electronic parts or products that include electronic parts to the DOD. A contractor is a "covered contractor" if it is subject to the Office of Federal Procurement Policy Act's cost accounting standards. Section 818 applies to every tier in the supply chain and all electronic parts, no matter how simple or complex.

Continued on page 2

Volume 9, Issue 3 August 2012

Department of Defense Cracks Down on Counterfeit Electronic Components, *continued from page 1*

The new contractor requirements will place the burden of detecting and avoiding counterfeit electronic parts on defense contractors. Under the new rules and requirements:

- the DOD will not pay for counterfeit or suspect counterfeit electronic parts;
- contractors must provide corrective action to remedy the use or inclusion of counterfeit parts, at the contractor's cost;
- contractors must manage their supply chains to eliminate the risk of counterfeit parts or face civil and criminal penalties for failing to do so;
- contractors must report to the government, within 60 days, any parts that they receive and "have reason to suspect" might be counterfeit;
- DOD must identify "trusted suppliers," and there will be a limitation on the ability of contractors to buy parts from anyone other than original equipment manufacturers (OEMs), the OEMs' authorized dealers, or these "trusted suppliers";
- DOD will have to set up a program to help improve contractor systems for detecting and avoiding counterfeit parts, which will include things like employee training, inspection and testing guidelines, mechanisms to enable traceability of parts, and flow down of counterfeit detection and avoidance requirements to subcontractors and suppliers; and
- a new criminal offense for trafficking in counterfeit goods or services, with severe penalties (for a first offense, an individual may be fined up to $2 million and face up to 10 years in prison, while a corporation may be fined up to $5 million).

The implications of this legislation for covered contractors are significant. Implementing these requirements will likely result in significant nonrecurring costs for covered contractors. Presumably these costs will be recoverable on DOD contracts, but the cost of counterfeit parts purchased by the contractor or corrective action to remedy the use (even accidental use) of such parts will not. Under the NDAA, contractors will also face the risk of civil and criminal penalties, as well as suspension, debarment, and possible *qui tam* actions filed by their own employees under the False Claims Act, if they do not meet the NDAA's requirements.

FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 9, Issue 3 August 2012

Department of Defense Cracks Down on Counterfeit Electronic Components, *continued from page 2*

The requirement to buy directly from OEMs, approved dealers, and "trusted suppliers" will also shrink the pool of suppliers contractors can use to buy electronic parts. Since the supply of parts for older defense projects is often reduced due to parts becoming obsolete and harder to find, these new requirements may negatively impact the ability of contractors to find the parts they need in order to meet the DOD's requested delivery schedules. While the goal of Section 818 is certainly a worthwhile one, some contractors will have difficulty adjusting their supply chains to meet the new requirements. Contractors need to start planning now for how they will modify their policies and procedures to meet the requirements of Section 818.

Alabama Passes Law Prohibiting Product Liability Lawsuits Against "Distributors"

In June of 2011, Alabama enacted the Alabama Small Business Protection Act (S.B. 184), a bill aimed at preventing lawsuits against sellers of products that cause personal injury, death, or property damage, if those sellers did not directly contribute to the alleged injury or damage. Before the law was passed, distributors, wholesalers, dealers, retailers, and other parties that sold products, as well as individuals or businesses who used products in the production or delivery of their own products and services (collectively referred to under S.B. 184 as "distributors"), could be sued if the products they sold or used in providing their own products or services caused some physical injury or property damage. The Alabama Legislature, as part of its larger tort-reform efforts, decided to prohibit such actions, unless there is some indication the distributor's conduct somehow caused the claimant's injury. Examples of conduct that could still lead to an action against a distributor include manufacturing a product or exercising substantial control over its design or altering an existing product, if those actions are related to the product's defective condition. The idea behind the law is that sellers should not be subject to lawsuits if they are simply acting as a middleman and did not actually cause the alleged harm.

FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 9, Issue 3 August 2012

Alabama Passes Law Prohibiting Product Liability Lawsuits Against "Distributors" *continued from page 3*

The law contains one exception. If, after performing due diligence to determine who manufactured the defective product, a claimant is unable to locate the manufacturer, the claimant can bring suit against the distributor. In order to do so, the claimant has to provide an affidavit certifying that he or she made a good faith effort to locate the manufacturer, but was unable to do so. Once suit is filed, the distributor can file an affidavit identifying the manufacturer. If that is done, the claimant must make an effort to file suit against the manufacturer. If a lawsuit against the manufacturer is then filed, the claimant has to dismiss its action against the distributor. The end result is that the distributor is probably off the hook if it can identify the manufacturer.

S.B. 184 is limited to product liability actions, and does not impact a distributor's liability for independent actions unrelated to the manufacture or design of a product. This law applies to all product liability actions commenced on or after June 1, 2011.

FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 9, Issue 3 August 2012

Fees & Burgess, P.C., Calendar of Events

Employment Records, Retention, Retrieval, and Destruction

Date: September 20, 2012
Time: 7:30 a.m. – 4:30 p.m.
Location: Birmingham Marriott - Birmingham, Alabama
Cost: 397.00 for first attendee, $297.00 for each additional attendee

Jeffrey Roth, Allen Anderson, and Allison Chandler, with the Huntsville, Alabama, law firm of Fees & Burgess, P.C., in partnership with M. Lee Smith Publishers, a national provider of information resources for Human Resources professionals, will present Employment Records Retention, Retrieval, and Destruction, a one-day workshop on document management best practices. The event, designed for Alabama employers, HR executives, and corporate legal counsel, will be held Wednesday, September 20, 2012 this webinar.
Those who choose to participate in this event will learn:

- Which documents should be kept and are vital, and how to keep a record of a workplace investigation
- Who “owns” an employee's personnel records
- Special document challenges
- How to store electronic data
- Time requirements in recordkeeping
- Proper methods of disposal

For more information, please click here to visit the HR Hero Website. This program has been approved for 5.75 recertification credits through the HR Certification Institute.

For more information on these, and other future events, please visit us online at www.feesburgess.com, or contact us at seminars@feesburgess.com.

FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 9, Issue 3 August 2012

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