

Criminal Prosecution - Who can be held liable for the sale of counterfeit parts?

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On September 14, 2010, the late Shannon Wren, owner of VisionTech Components ("VisionTech"), and Stephanie McCloskey, VisionTech's Administrative Manager, were arrested during the execution of search and seizure warrants issued against the pair by the United States government after evidence connected them to the sale of counterfeit parts to the U.S. Navy, defense contractors and others. A ten-count indictment charged McCloskey with conspiracy, aiding and abetting in violation of Title 18 United States Code, Sections 371 and 2; trafficking in counterfeit goods, in violation of Title 18 United States Code, Section 2320; and mail fraud, in violation of Title 18 United States Code, Section 1341. McCloskey pled guilty to conspiracy and aiding and abetting for her role in the scheme.

Shannon Wren, the former owner of VisionTech Components, was scheduled for a June 6, 2011 hearing on a government motion for revocation of conditions of release. His trial was scheduled to begin on November 30, 2011; Wren died of an apparent drug overdose on May 26, 2011. The prosecution of Shannon Wren was abated having no impact on the charges against McCloskey. McCloskey is scheduled for sentencing before the US District Court for the District of Columbia on September 30, 2011. Despite the fact she was not an officer of VisionTech nor was she considered a key stakeholder in the corporation, McCloskey faces up to 5 years in prison for willfully turning a blind eye to the illegal activities that took place within the VisionTech organization.

This article is intended to serve as a warning to sales, purchasing and management representatives involved in the purchase or sale of integrated circuits in the open market. You are not untouchable merely because you are not an owner/officer of the company for which you are employed. On the contrary, you could be arrested and prosecuted if you, like Stephanie McCloskey, "choose to ignore the obvious".

Here is the obvious:

CBP Seizures are not challenged

*"On thirty-five (35) separate occasions, importations of integrated circuits by VisionTech were seized at U.S. Ports of entry as counterfeit. VisionTech never challenged a single seizure. However, Wren and McCloskey sent the identical version of a letter to CBP requesting that no fines or penalties be assessed."*¹

If a shipment is seized, communicate honestly with CBP. If they provide you with evidence to support the in transit goods were falsely represented, falsely declared, erroneously diverted through Hong Kong or suspect counterfeit, the safest course of action is to remove this supplier from your AVL. Continuing to buy from a supplier that has been identified by CBP as supplying/shipping nonconforming or suspect counterfeit parts sends the message you are willfully and knowingly procuring parts from a known counterfeit source.

Goods are falsely represented

- Parts are represented as in stock when they are, in fact, not in your stock.
- Parts are represented as OEM/OCM excess when they are, in fact, not coming from an OEM/OCM.
- Parts are represented as having traceability when, in fact, no product traceability is available. (Note: Parts represented as coming from an authorized distributor but that were not directly procured from an authorized distributor is a misrepresentation. Just because your organization is told parts are coming from OEM excess or authorized distribution does not mean that is where the parts were derived from.)
- Parts are represented as new but have been altered (e.g. refurbished, markings altered, packaging altered, etc.).

"VisionTech employees were instructed to mislead buyers who inquired about the country of origin for ICs by telling them that the goods were coming from an OEM in Europe. If the buyer pressed for more details, employees were instructed to say

that the ICs came from Germany" "On numerous occasions, Integrated Circuits purchased by VisionTech Components from China and Hong Kong arrived in dirty condition. Wren directed employees to use large erasers to remove debris and discoloration from the leads of the devices and essentially polish the leads on the integrated circuits making them appear to be in good condition."

"On at least one occasion, Wren directed Defendant McCloskey to send integrated circuits bearing multiple date codes to China to have all of the integrated circuits re-marked with the same date code. Defendant McCloskey did as she was instructed."²

Do not misrepresent the origin of goods. Be honest and up-front relative to the product's origin and condition. It is better to err on the side of caution. Do not take your supplier's word for anything. If there is no documentation to substantiate the product's pedigree or condition, then represent the goods as "origin unknown" and rate the risk as high. By doing so, you and your customer can take the necessary steps to mitigate the risk of a counterfeit incident.

Bait-and-Switch

"Some VisionTech customers insisted on receiving samples of devices in advance so that they could test the parts in advance of placing their order. The Government's investigation suggests that VisionTech would send legitimate sample devices, which passed buyer testing, but orders were fulfilled with counterfeit goods."³

When samples are requested, take steps to ensure they derive from the same lot of material as the lot that will ultimately be delivered to fill the order. If you do not have the material in your possession but instead are relying on your supplier to provide samples followed by a second subsequent delivery, presumably from the same lot, disclose this to your customer. This way both you and the customer can ensure parts from both shipments are analyzed for authenticity and functionality.

Parts are not being thoroughly inspected upon receipt and prior to resale

"During the investigation of this case, the Government performed a forensic accounting analysis of VisionTech's financial activities and those of its related business entities. This detailed analysis reveals that during the time period covered by the Indictment, December 2006 to September 14, 2010, VisionTech sold ICs to approximately 1,101 buyers and received approximately \$15,888,599.00 in gross receipts, representing the sales of integrated circuits. During that same time frame, VisionTech expended approximately \$7,687,225.00 to purchase goods, but spent only \$14,742.00 on testing."⁴

A supplier that procures parts from the open market and then resells the parts without first verifying the authenticity of the parts being sold is placing its customers at risk. No supplier should sell or represent parts as new if the parts were not procured directly from an authorized source or without direct traceability to an authorized source (e.g. parts were purchased from OEM excess and OEM purchased the parts from an authorized distributor).

The days of just being a broker are gone. The risks associated with purchasing and selling suspect counterfeit parts and the criminal penalties associated with doing so requires all parties in the supply chain to take appropriate measures to mitigate this risk. The basic minimum authenticity verification processes that should be applied by distributors procuring and selling untraceable parts are:

- Marking permanency testing
- Microscopy
- X-Ray analysis
- De-cap (die analysis)

ERAI strongly recommends incorporating IDEA-STD-1010-B (Acceptability of Electronic Components Distributed in the Open Market) into your inspection process to reduce the risk of a counterfeit occurrence. This is the most comprehensive guide to conducting visual inspections available on the market.

When a definitive process for the detection of microblasting has been identified, this too will need to be incorporated into your incoming visual in-

spection process.

Supply a copy of your inspection report as evidence the aforementioned precautions were taken and store your inspection records for no less than 10 years. Should an incident occur, work with your customer and supplier to either confirm or negate the findings. Suppliers that merely argue that the nonconformance is being reported outside of the specified warranty period will be viewed negatively should your organization become the subject of a criminal investigation.

Sales/Performance history is falsely represented

1. Claims are made the parts have been sold before with no prior complaints, when there is no sales history.
2. Claims are made parts have been sold before with no prior complaints when previous part purchases were made using various and/or multiple suppliers as opposed to a single source.

A valid sales history can offer insight into claims of an electrical nonconformance but if not accompanied with documented evidence that proves the past shipments were evaluated for both authenticity and functionality, the reality is that you may have sold functioning counterfeit parts. There is no disputing that many reclaimed, salvaged and remarked parts do function; the question is how long will they function. Even if there is a successful sales history, be prepared to work with your customer to investigate/resolve the issue. All avenues must be explored and you will likely be asked to back up your claims by providing traceability to the source from which the goods were procured along with copies of every order you have received since procuring those goods. If you are not willing to do that, your sales history has no value.

Purchases are made from sources with previous/habitual nonconformance issues

1. Organization does not maintain an approved supplier process and does not blacklist suppliers with weak performance histories but rather continues to procure from sources who have repeatedly supplied suspect counterfeit parts.

*"From January 1, 2007 to June 7, 2010, VisionTech imported approximately 3,263 shipments. Therefore, barely more than one percent of all VisionTech imports were stopped at U.S. ports and prevented from entering commerce. However, the government has documented in its investigation, that 95 percent of all goods acquired by VisionTech came from the same counterfeit supplier in China."*⁵

Blacklist problematic suppliers. Establish a corporate policy that clearly defines supplier expectations and penalties for noncompliance. ERAI elected to incorporate a three strikes rule. We understand that a product nonconformance can happen to even the most well informed and diligent supplier. We do not want to harshly penalize what may have been an oversight, but when a pattern of behavior begins to emerge, action must be taken. If action is not taken, then your organization may appear as though it is a willful participant in the purchase and sale of suspect counterfeit parts. A clearly defined set of vendor requirements and adherence to the established corporate policy will send the message your organization is working diligently to weed out high-risk suppliers.

False Documentation

1. Purchase orders, invoices and/or packing slips are falsified yet the organization continues to make purchases from the source that placed either false data or false values on paperwork.

*"As early as December 12, 2007, Defendant McCloskey attempted to frustrate CBP interdiction efforts to keep counterfeit goods out of the country. She directed employee "Myra" in accounting to tell each of their suppliers to list all future shipments as "Electronic Components" and not as "Integrated Circuits." The reason for this action is highlighted in Myra's words captured in an instant message log recovered from the VisionTech computers. Myra stated to a supplier, "[W]e are trying to go around customs, they are pulling everything that states Integrated Circuits...just write down electronic components and the correct value to match our PO."*⁶

Avoid procuring parts from suppliers that falsely represent their shipments or its value. These are

red flags for CBP. When enforcement witnesses repeat shipments destined for a single location and data is clearly misrepresented, it may be assumed you have authorized the misrepresentations, thus implicating your organization in a wrong-doing. Always ensure shipping records are accurate. If a supplier ignores your instructions, remove this supplier from your AVL and document why this action was taken.

Shipment from Shenzhen and other areas in Mainland China are rerouted through Hong Kong

*"Since the Government's forensic accounting analysis documented that at least 95 percent of the goods VisionTech procured came from China, it is believed that shipments from Hong Kong were part of a transshipment scheme intended to frustrate CBP's interdiction efforts, making it appear as though goods actually originating from China came from Hong Kong."*⁷

Issuance of Certificates of Conformance on untraceable, untested parts

*"VisionTech employees created false Certificates of Conformance, 25 which were shipped to numerous buyers along with the devices purchased. The "certificate," which is on VisionTech letterhead, references the purchase order number, customer, date, quantity, part number manufacturer, date code and condition - which is always reflected as "NEW," even though the company was selling salvaged and remarked counterfeit devices. The certificate states in part, "This is to certify that all items in this shipment have been inspected and conform in all respects to the specifications and requirements applicable to the above referenced purchase order..." The certificate purports to be signed by a VisionTech "Quality Representative" although no person with any such training or background was actually employed by VisionTech. VisionTech employees shipped counterfeit integrated circuits along with fraudulent Certificates of Conformance to customers in the United States and abroad."*⁸

A "Certificate of Conformance", also referred to as a "CofC", is a document which the buyer may require the distributor to provide as a condition of the purchase. This certificate is a written docu-

ment, completed by the distributor, which certifies, among other things, that the parts being provided are what they are represented to be in accordance with the purchase order and meet form, fit, and function criteria. Parts that are purchased via the open market and that do not have product traceability and that have not been tested should not be sold with a CofC. A supplier providing parts that were sourced from the open market that did not test the parts for both authenticity and functionality cannot, in good faith, assert the parts are authentic and in good working condition.

Customers are misled - False statements are intentionally & maliciously made to customers

"As of the time of Indictment, the Government was aware of five customer complaints and \$1.2 million in refunds, which presumably stemmed from customer complaints. Once the Government began to search through hard copy records recovered from the VisionTech offices and also search through the voluminous emails, instant messaging and other computer records, an extremely disturbing pattern of behavior became apparent, which involved social engineering in aid of fraud. For example, an undated, handwritten page of notes was found in Defendant McCloskey's office, which suggests that a meeting took place in which directions were given as to the way to handle customer complaints. The document's contents indicate that Defendant McCloskey was the author, as the notes state:

"Raise min order to \$400 Broker Deals. If you need an exception see me or SW."

"Fight RMA's" "Test report/Act Surprised."

"Think outside the box," "Problem with solution," "What would we ask," "Who is testing/how long?"

"All orders C.O.D."

***"The term "social engineering" as used here, means the attempt to manipulate others through trickery or deception for the purpose of perpetrating fraud."*⁹

Conclusion

Ignorance is not a defense. It will likely be diffi-

cult, if not impossible, for any representative of the open market to argue that they were "unaware" of the risks plaguing the supply chain or "unaware" their actions were criminal in nature. Organizations that participate in all, or in part, of the aforementioned practices are doing more than merely exercising willful blindness; they are operating with a reckless disregard for human life and safety.

No one is immune to prosecution.

Ignoring the obvious places you and the organization you represent in jeopardy.



With nearly two decades of experience, Kristal Snider has developed a keen understanding of the problems affecting the global electronics supply chain. Kristal is responsible for managing ERAI's complaint processing team, establishing

complaint protocol, development of corporate policies and procedures and the creation of the ERAI Grievance Committee. She has organized more than a dozen conferences, trainings and educational seminars and has presented at various conferences and industry events. She was directly involved in the formation of the industry's first escrow service (eraiESCROW), the formation of IDEA (Independent Distributors of Electronics Association) and is a founding and active member of the SAE International G-19 Counterfeit Electronic Components Committee and several subgroups.

REFERENCES

- ¹ United States of America v. Stephanie A. McCloskey
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