

Counterfeit electronic parts flood U.S. market

By Keith M. Gregory

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Electronic components are essential to our daily lives. They are incorporated into medical devices as well as cell phones, our automobiles and MP3 players. Also, electronic components are incorporated into sophisticated military and aerospace items. Unfortunately, the number of counterfeit electronic parts being produced and sold by unscrupulous manufacturers has exploded in the last 10 years, flooding the military, aerospace and commercial markets. This flood of counterfeit electronic parts was abrupt and unanticipated. By the time government and commercial contractors, distributors, and the federal government began to recognize the scope of the problem, millions of counterfeit parts had entered the supply chain.

In mid-2007, the U.S. Department of the Navy began to suspect that an increasing number of counterfeit electronic parts were permeating the U.S. Department of Defense supply chain, and it asked the Bureau of Industry and Security's Office of Technology Evaluation, under the Bureau of Commerce, to conduct a base assessment of the counterfeit electronics in the supply chain. In January 2010, the Department of Commerce released its study in a report titled "Defense Industrial Base Assessment: Counterfeit Electronics." The findings of the Department of Commerce were shocking. Between 2005 and 2008, the incidents of counterfeit electronic parts encountered by original component manufacturers more than doubled. In fact, the incidents of counterfeit electronic parts increased in every industry tracked in the study, and the Department of Defense encountered counterfeit electronic parts in "every type of discrete electronic component, microcircuit, bare circuit board, and assembled circuit board."

The Department of Commerce found that "[t]he proliferation of counterfeit parts is not limited to occasional, isolated incidents, but is increasingly present at every level of the supply chain." It further concluded that "[n]o type of company or organization has been untouched by counterfeit electronic parts. Even the most reliable of parts sources have discovered counterfeit parts within their inventories."

In 2011, the Senate Armed Services Committee followed up on the Department of Commerce's assessment of the

counterfeiting industry, initiated an investigation and held a hearing in November 2011. The SASC investigation confirmed the Department of Commerce's findings that counterfeit electronic parts had flooded every aspect of the supply chain.

The problem of counterfeit electronic parts in the supply chain stems not from American contractors and distributors, but from the actions of the counterfeiters, many of whom are based in China. These counterfeiters take fake and used parts (obtained from electronic waste imported from the United States) and disguise them to look like genuine new parts so that they can be sold to contractors and distributors in the United States.

In ideal situations, contractors can source electronic parts directly from the original component manufacturers, thus minimizing the risk of receiving counterfeit parts. But the original manufacturers often stop producing the needed electronic parts long before the lifecycle ends for the products in which they are used. Reengineering or redesigning the electronic parts is usually prohibitively expensive, and procurement agents often find it necessary to purchase aftermarket manufactured parts to replace worn parts in the still useful products. Because sourcing these aftermarket parts from unknown sources is often the only option, there is a risk that counterfeiters will introduce counterfeit parts into the supply chain.

The federal government too has struggled to stay ahead of the flood of difficult to detect counterfeit parts. A March 2010 report by the Government Accountability Office noted that the Department of Defense was only in the "early stages of gathering information on the counterfeit parts problem" and had not adopted a uniform definition of "counterfeit parts." And in its 2010 assessment, the Department of Commerce observed that the Department of Defense had not yet established regulations for authenticating parts or reporting incidents of counterfeiting.

Indeed, there is no Department of Defense-wide recognized definition of "counterfeit parts." There are no regulations establishing authentication procedures. There are no reporting requirements. And the department relies on antiquated procurement and quality control practices that are not specifically designed to address counterfeit electronic parts.

Both the Accountability Office and the Department of Commerce recognize that the government needs to act to help prevent counterfeiters from introducing counterfeit parts into the supply chain.

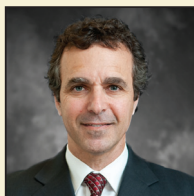
The recent flood of counterfeit parts being manufactured and the lack of guidelines have resulted in largely inconsistent anti-counterfeiting procedures being employed by different distributors. Even when distributors identify counterfeit electronic parts, they are uncertain as to what actions they should take or to whom to report the counterfeiting. Largely due to this confusion, as the Department of Commerce documented in 2010, only 9 percent of independent distributors reported notifying federal authorities after learning that a counterfeit part had shipped. Fortunately, some distributors have independently taken leading roles in attempting to reduce the risk of counterfeit products entering the supply chain. These distributors use sophisticated testing and inspection procedures, maintain approved supplier lists, have begun to avoid sourcing materials from identified high risk areas, quarantine suspect counterfeit parts, and work with organizations dedicated to fighting counterfeiting.

The government has recently begun to address the growing counterfeiting problem and looks to soon establish universal protocols for contractors and distributors to follow. On Nov. 29, 2011, Sen. Carl Levin introduced an amendment to the National Defense Authorization Act that begins to establish guidelines for the detection and reporting of suspect counterfeit electronic parts. The amendment passed and was signed into law by President Barack Obama on Dec. 31, 2011. It gives the Secretary of Defense six to eight months to define

“counterfeit electronic parts” and establish regulations aimed at keeping counterfeit parts out of the Department of Defense’s supply chain. These regulations will finally give contractors and distributors much needed guidance on what constitutes a counterfeit part, procedures to minimize the risk of passing counterfeit parts along in the supply chain, and what actions to take if a company believes it was sold counterfeit parts.

In addition to initiating the development of universal reporting and testing procedures, the amendment aims to target bad actors who are responsible for counterfeit parts entering the government’s supply chain. It directs the Secretary of Defense to develop remedial actions, including suspension and debarment, against suppliers who repeatedly introduce counterfeit parts into the supply chain. Levin emphasized that the amendment was aimed at those suppliers who “repeatedly fail” to avoid placing counterfeit parts into the supply chain, rather than diligent suppliers who are themselves occasional victims of counterfeiters who flood the market with their parts. In this manner, the amendment attempts to strike a balance between going after repeat offenders, who have shown a deliberate lack of diligence in attempting to keep counterfeit parts out of the supply chain, with the acknowledgment that some counterfeit parts can slip through even the most rigorous anti-counterfeiting measures.

These steps taken by federal government will have the effect of creating a more level playing field where counterfeiters will no longer be able to control the market and make it a safer place for manufacturers, distributors and consumers.



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Keith Gregory practices in the areas of general business matters, corporate, franchise and partnership disputes, and intellectual property and commercial litigation. He is an experienced litigator, with considerable background in intellectual property issues, licensing agreements, trade secret matters and Uniform Commercial Code issues, especially within the electronic components and semi-conductor industries. Keith was recently appointed to the SAE International AS6081 Committee, established to develop standards proscribing counterfeit parts avoidance requirements for independent distributors.

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