

Case Study: Skilled Procurement Ring Charged in Illegally Obtaining Goods for Iran

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On April 16, 2015, the United States District Court in the Southern District of Texas indicted five individuals and four companies on 24 counts related to illegally exporting sensitive military microelectronics and power supplies to Iran.¹ The defendants, including the individuals Bahram Mechanic, Khosrow Afghahi, Tooraj Faridi (all three described as "United States persons"), Arthur Shyu, Matin Sadeghi, and the companies Faratel Co., Smart Power Systems Inc., Hosoda Taiwan Limited, and Golsad Istanbul Trading Ltd., are charged with violating the International Emergency Economic Powers Act by "exporting high-tech microelectronics, uninterruptible power supplies and other commodities to Iran."² These technologies had uses in "military purposes, including surface-to-air missiles and backup power sources for military or nuclear energy systems."³ The defendants are also charged with money laundering, conspiracy, and related offenses. They allegedly used multiple foreign financial transactions to launder Iranian payments for the goods.

According to a Department of Justice press release, the defendants Mechanic and Faridi utilized their Houston, Texas company, Smart Power Systems, with the assistance of Afghani who was based in Los Angeles, to illegally procure U.S. military microelectronics and power supplies and send them to an Iranian company, Faratel, owned by Mechanic and Afghani. The indictment describes Smart Power Systems and Faratel as "sister companies," with Smart Power Systems used to acquire microelectronics and goods that outfitted Faratel's uninterruptible power supplies products, which were sold to sanctioned Iranian government agencies and private customers. Faratel provided shopping lists of needed goods to Mechanic, Faridi, and Afghani for purchases in the United States. Defendant Shyu and his Taiwan company, Hosoda Taiwan Limited, acted as the foreign "buyer" of the goods; goods were shipped to him and he would

¹ United States District Court in the Southern District of Texas, *Grand Jury Indictment: United States of America v. Bahram Mechanic, Khosrow Afghahi, Tooraj Faridi, Faratel Co., Smart Power Systems Inc., Arthur Shyu, Hosoda Taiwan Co. Ltd., Matin Sadeghi, and Golsad Istanbul Trading Ltd.*, dated April 2015.

http://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/04/17/ieepa_indictment.pdf

² Department of Justice Press Release, "Four Companies and Five Individuals Indicted for Illegally Exporting Technology to Iran," April 17, 2015. <http://www.justice.gov/opa/pr/four-companies-and-five-individuals-indicted-illegally-exporting-technology-iran>

³ Delvin Barrett, "Five Charged With Conspiring to Violate Iran Sanctions," *The Wall Street Journal*. April 17, 2015.

send the shipments onward to Matin Sadeghi and his Turkish shipping company, Golsad Istanbul Trading Ltd., where they were diverted to Iran. In some cases, the goods were ordered by Shyu in Taiwan and shipped directly to Iran.

This alleged illicit procurement network is estimated to have "obtained at least approximately 28 million parts valued at approximately \$24 million from companies worldwide and shipped these commodities to Iran..." The indictment alleges that the defendants illicitly provided these technologies to "both commercial entities and Iranian Government agencies, such as the Iranian Ministry of Defense, the Atomic Energy Organization of Iran and the Iranian Centrifuge Technology Company (TESA)." U.S. sanctions prohibit unauthorized dual-use military sales to these Iranian entities. Mechanic, Faridi, and Afghani will stand trial for their alleged offenses. Defendants Sadeghi and Shyu continue to reside in Turkey and Taiwan.

Following the indictment, the Department of Commerce added seven foreign nationals and entities to the U.S. Entity List, which prohibits U.S. companies from doing business with them. Among other lessons, this case highlights the persistent problem posed by Turkey as a proliferant state turntable. Taiwan has made important reforms but is still targeted by smugglers as an illicit trading company outpost. It also highlights that Iranian procurement agents continue to seek sensitive goods from inside the United States and increase the sophistication of their schemes in order to reduce chances of detection.

The Scheme

From on or about January 2010 to the present, the defendants operated a procurement scheme to illicitly supply U.S. microelectronic technologies to Iran. The scheme was allegedly orchestrated by one defendant in particular, Bahram Mechanic, who had been engaged in and investigated for past involvement in illicit trade with Iran. Between 1985 and 2012, Mechanic faced U.S. government investigations, including a criminal conviction and civil action for activities carried out on behalf of Iran. According to the indictment, Mechanic was able to use these experiences to shape a new illicit procurement scheme that was more difficult for U.S. authorities to detect. He apparently profited handsomely; in 2014, he claimed personal assets of more than \$8.5 million in the United States and \$12.5 million in Iran in addition to ownership of Faratel, valued in 2013 at \$18 million.

The Grand Jury Indictment describes the scheme as a collaborative effort between the nine defendants, with oversight conducted by Mechanic: Faratel would provide Mechanic with a list of desired goods, Mechanic would approve the transactions and coordinate with Shyu to order these items through Shyu's Hosoda company in Taiwan, and then Hosoda would arrange shipment of the goods to the Turkish company Golsad, where Sadeghi would divert them to Iran. At times, Shyu would receive and then divert goods directly to Iran. If the shipment were to take the indirect route, then Sadeghi would facilitate the transaction by falsely representing his Turkish company Golsad as the buyer and recipient of the items, before delivering them to their true destination in Iran. Faridi and Afghani assisted in the processing of orders, shipping of goods, and organizing of the network.

Specifically, the sensitive technologies involved in this case include the microelectronics of microcontrollers, digital signal processors, and uninterruptible power supply technology. All three of these technologies have dual-uses for military purposes, and the uninterruptible power supply (UPS) technology is especially important in the nuclear energy sector as it provides a back-up power source when normal power is unavailable.

In terms of payment mechanisms, Faratel would often send payments to Golsad in Turkey, which would then be sent to Hosada in Taiwan. Currency was converted from Iranian Rials to US dollars, Euros, Turkish Lira, or Japanese Yen to avoid detection and sent via Singapore and Hong Kong. Faratel used bank wire transfers, involving multiple different foreign companies, to make payments to the defendants in this case. The amounts exchanged in these money transfers were kept small on purpose so that banks would not become suspicious of the transactions: often internal transfers were kept below \$5,000 and external transfers were kept below \$10,000. Mechanic also considered exchange rates in making these transactions, which demonstrates his awareness of external factors that can influence profits. Considering the caution with which the defendants executed the monetary and goods exchanges in this scheme, it is clear that they had gained experience and were consistently improving their techniques.

Lessons and Observations

This case demonstrates the ways in which smugglers adapt to enforcement mechanisms. After Bahram Mechanic was being investigated for his past illicit trade activities spanning from the 1980s, he utilized his experiences and understanding of trade monitoring efforts to construct a more evasive scheme. The indictment shows that the smugglers were aware of the need to not mention an Iranian end user or indicate its logo on customs labels, not use official e-mail addresses, and add non-export controlled goods to orders that would make them appear more diverse and therefore more innocuous. The smugglers were also aware of financial sanctions on certain Iranian banks, such as Bank Mellat, and the need to conceal the origin of funds and use non-sanctioned means of financial exchange.

This case shows that Faratel essentially used Smart Power Systems in Houston, Texas as a supply point to funnel huge amounts of goods to Iran. It is troubling that smugglers working for Iran can simply set up shop in a country with aggressively enforced export control laws and operate unhindered for several years. In this context, past investigations and prosecutions into Mechanic's activities did not deter future engagement in such activities. Mechanic's financial gains indicate a great economic incentive for continued participation in illicit procurement schemes. More severe penalties for participation in illicit trading schemes – higher than the typical U.S. sentence of under five years of jail time for egregious offenses – may be justified as a way to minimize repeat offenders and affect the calculus of those who are considering participating.

With respect to the states involved as middlemen, Taiwan and Turkey, it is important to recognize that Turkey is frequently targeted as a turntable because of its weak export control

system.⁴ The defendants chose Turkey and the company Golsad because it suited their needs of finding a "cut out company in a different country that could receive the transistor and forward it to Iran" without requiring an export license. Turkey should undertake efforts to better monitor their exports by considering the goods being exchanged and the destination of these items. If they have not, Taiwan and Turkey should arrest and prosecute Shyu and Sadeghi and penalize their companies.

Iran again appears willing to bypass sanctions to further its military capabilities and outfit its nuclear program. If Iran is able to acquire sensitive technologies in a system with unprecedented sanctions, what will limit Iran's ability to acquire these technologies once these sanctions are removed, either immediately or in phases, under comprehensive deal? Once sanctions are removed, it will certainly be easier for Iran to expand its global trade partnerships and potentially violate its commitments if a strong detection and enforcement system is not in place.

⁴ David Albright, Andrea Stricker, and Houston Wood, *Future World of Illicit Nuclear Trade: Mitigating the Threat*, Institute for Science and International Security, July 29, 2013.