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ENFORCEMENT AND PENALTIES

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A failure to comply with the customs laws can expose importers to civil and criminal liability.

Criminal. Criminal prosecutions of customs violations are relatively rare. Two factors explain this. First, they are relatively complex, both legally and factually, and usually require the examination of a great deal of arcane documentation by juries. Federal prosecutors do not like these types of cases. Second, in the case of corporate defendants, the criminal penalties can be lower than the potential civil penalties. Thus, unless the government wants to make a case against an individual, where incarceration is a possibility, it is not unusual for a federal prosecutor to decline to prosecute a criminal case arising under the customs laws.

Civil. United States Customs and Border Protection ("Customs") enforces numerous civil penalty provisions. Civil offenses usually result in the imposition of monetary penalties and/or forfeiture of the imported merchandise.

Section 592 of the Tariff Act of 1930 is the basic and most widely used penalty provision. It provides for the imposition of monetary penalties against any person who imports, attempts to import, or aids or procures the importation of merchandise by means of false or fraudulent documents or practices unless that person "has reasonable cause to believe the truth" of the false statement. False or fraudulent omissions of material facts are also covered. Material facts are those that have the potential of affecting duty liability or admissibility as well as statistical data.

Section 592 infractions are divided into three categories of culpability, each giving rise to a different maximum penalty

A. Fraud - This category involves an act of commission or omission voluntarily and intentionally done. The maximum penalty for a fraudulent

violation is a monetary penalty equal to the domestic value (generally entered value times two plus duty) of the merchandise.

B. Gross Negligence. This category involves an act of commission or omission done with actual knowledge of, or wanton disregard for, the relevant facts and a disregard of statutory obligations. The maximum penalty for gross negligence is the lesser of domestic value or four times the loss of revenue. If the infraction does not affect the revenue, the maximum penalty is 40 percent of dutiable value.

C. Negligence. This category involves a failure to exercise due care in ascertaining the material facts or in ascertaining one's obligations. The maximum penalty for negligence is the lesser of the domestic value of the merchandise or twice the loss of revenue. However, where there is no loss of revenue, the penalty cannot exceed 20 percent of dutiable value.

The same transaction can involve both duty and non-duty violations and the courts have ruled that these can justify separate penalties.

In addition to any penalty, Customs will require payment of any unpaid duties and fees plus interest.

If Customs has reasonable cause to believe that the importer is insolvent or beyond the jurisdiction of the United States, or for other reasons believes that seizure is necessary to protect the revenue or to enforce import restrictions, the merchandise may be seized and will be forfeited to the United States if the penalty assessed is not paid or if adequate security is not given.

D. Prior Disclosure. If an importer makes a prior disclosure of an infraction arising out of fraud, the penalty is limited to an amount equal to the loss of revenue or where there is no loss of revenue, 10 percent of dutiable value. However, if the violation disclosed does not amount to fraud, the maximum penalty is the interest on the lost revenue measured from the date of liquidation. A prior disclosure is one made without knowledge that Customs has commenced a formal investigation. Customs position is that sending a CBP Form 29 to an importer indicating that an investigation is commenced, is notice of a formal investigation.

As stated, making a prior disclosure can limit the penalty. Nevertheless, importers should not make a prior disclosure without seeking the advice of counsel. A prior disclosure that reveals fraudulent activity can be used as the basis of a criminal prosecution.

E. Procedure. These penalties are not imposed until certain formal procedures are followed. The initial procedure is a pre-penalty notice that normally will provide a 30-day response period. After reviewing any response,

Customs may issue a penalty notice. An importer may respond to this penalty notice by filing a petition in mitigation.

The circumstances that Customs may consider in mitigating a penalty include:

- cooperation in the investigation
- removal of a blameworthy employee
- correction of organizational defects within the importer's organization
- inexperience in importing
- absence of prior violations
- contributory error on the part of Customs officials
- inability to pay the penalty
- Customs knowledge.

Customs considers the following aggravating factors in setting a penalty:

- obstructing an investigation or audit
- withholding evidence
- providing misleading information concerning a violation
- prior violations for which a final administrative finding of culpability has been made
- textile imports that have been the subject of illegal transshipment
- evidence of a intent to evade import prohibitions or restrictions on the admissibility of the merchandise
- evasion of a lawful demand for records or a Customs summons.

If an importer is not satisfied with the results, it need not pay the penalty but can either try to settle the matter by making an offer in compromise or wait until the government files suit. Any such suit must be commenced within five years of discovery in cases involving fraud and five years from the date of entry in negligence cases. The government has the burden of proving the violation[1].

F. Waivers. It is usual that at some point during the course of a penalty proceeding, Customs will request that the importer execute a waiver extending the statute of limitations. This is another area where proceeding without the advice of counsel is imprudent. The waiver form used by Customs should not be used. Counsel will be able to negotiate a less onerous form.

G. Officer/Shareholder Liability. Customs can and will attempt to impose civil penalties against individuals. Usually the individual is the sole shareholder of the importer entity.

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[1] The government may not commence suit until it has completed the administrative prices. A failure to complete the process can lead to dismissal of the government's claim. *United States v. Nitek Electronics, Inc.*, 806 F.3d 1776 (Fed. Cir. 2015).

A 2014 Federal Circuit decision in *Trek Leather* holding that a corporate officer may be held liable for furnishing misleading documentation even if the officer is not technically the importer of record has raised concerns in this area. The case involved 592 claims and turned on the meaning of introduced as opposed to entered. The underlying violation was the failure to report assists. The individual was the president and sole shareholder of the importer. The importer had previously been found to have committed the same undervaluation errors in the past.

In the particular instance, the officer was directly involved in providing false invoices to the importer's broker.

CBP sued both the importer and the officer; the CIT held both liable. The individual appealed and in a divided decision, the Federal Circuit first held that the individual was not liable as he was not the importer of record. CBP sought review by the full Federal Circuit. On review, the Federal Circuit reversed itself and held that the individual was liable. *United States v. Trek Leather,* 767 F.3d 1288 (Fed. Cir, 2014).

There have been a number of cases where the courts have held individuals liable and many more penalty cases in which CBP has recovered penalties against individuals. This typically happens in smaller firms where the individual is the sole shareholder or one of a few shareholders and where the importer has insufficient funds to pay the penalties.

United States v. Sterling Footwear, 279 F. Supp. 3d 1113 (CIT, 2017) addresses a somewhat different issue in that it refers to misclassification rather than undervaluation, the issue in *Trek Leather.* In Sterling, the CIT held that an individual who misclassifies merchandise, or causes merchandise to be misclassified, in a document prepared for the purpose of entering goods, which that person causes to be shipped to and unloaded falls within the ambit of the term "introduce". In both *Sterling* and *Trek Leather*, the individual was the sole shareholder and principal manager of the importer.

It should come as no surprise that actively engaging in what appears to have been obvious misclassification can subject an individual to personal liability under Section 592. The importer entered almost all of its wide variety of footwear in HTS subheading 6402.91.40 (6%), regardless of upper material or the presence of a foxing or foxing-like band.

A recent penalty case filed in the Court of International Trade suggests that the government may be looking to recover penalties from individuals. Whether claims against an individual flow from the nature of the case rather than a change in government policy remains to be seen.

The case, *U.S. v. China Tire Warehouse, Inc.,* Court No. 15-00059, was filed in March 2015. The government alleges that between September 2005

and March 2007, defendant made over 150 entries of new tires under various duty-free provisions avoiding duty. The complaint also alleges that once these errors were brought to the importer's attention, it immediately began using other duty-free provisions. The complaint seeks a penalty of $16.8M and $242,028 in unpaid duties.

A footnote in the complaint indicates that while the government is not currently initiating an action against corporate officers, it could do so if sufficient evidence warranting personal liability comes to light.

Just after the complaint was filed, the defendant filed bankruptcy. This could well provide more incentive for the government to seek penalties against corporate officers and other individuals. The case remains pending although there has been no significant court activity since October 2016.

H. Liability for Acts of Others. A CIT decision in a penalty case involving an apparel importer highlights an important issue. Without going into great detail as to the circumstances of the case, suffice it to say that the importer outsourced customs clearance to a third party. The third party was responsible for picking up the merchandise overseas and providing for customs clearance. The third party falsified the entry documents by misdescribing and undervaluing the merchandise. Despite that, it charged the importer the amount that it would have paid had the merchandise been entered correctly. The third party advised its customer that it could pay duty based upon the price charged by the manufacturer rather than the vendor. The customer, who was skeptical of this advice, consulted an alleged expert who indicated that this was possible. (Presumably, the parties were talking about a first cost appraisement).

At some point, Customs uncovered the scheme and prosecuted the third-party service provider and its customer, the importer. The third-party service provider was convicted but the customer was acquitted.

Subsequently, Customs sought to collect the unpaid duties and a penalty against the importer by filing a penalty action in the CIT. The CIT held that the importer was responsible for making the government whole on the underpayment of duties. The court's theory was that the importer (principal) was responsible for the acts of the third party (agent). This was the case even though the agent acted unlawfully.

The court did not decide whether the distributor was liable for penalties, but held that over for trial. The case has been concluded. After settlement discussions failed, the defendant defaulted and was held liable for withheld duties, interest and penalties.

The lesson here is that if a broker, or other service provider, makes errors, the importer can be held responsible. That is the case even, as here, where the importer did not act as importer of record.

Customs has indicated that it believes that this decision allows it to seek to recover unpaid duties from DDP purchasers, presumably on the theory that the DPP vendor is the agent of the purchaser. The validity of this theory is questionable. Nevertheless, it prudent for DDP purchasers to ensure that as many contact points (placing the order, payment) with the DDP vendor are in the United States.

I. Compliance Programs. Customs actively encourages importers to develop and implement compliance programs. While, as a general rule, compliance programs are beneficial, their efficacy in the enforcement area is limited.

The dominant view of the federal courts is that a compliance program is not a defense in a criminal prosecution. However, some courts have held that the existence of an effective compliance program may be considered by a jury in assessing whether the employee's criminal acts were within the scope of his or her delegated authority and were intended for the benefit of the corporation. Also, the existence of an effective compliance program is a factor in the decision to prosecute.

Compliance programs probably have a greater influence in the civil area. A strong compliance program will eliminate many mistakes. A strong compliance program will discover mistakes and will permit the filing of prior disclosures where appropriate.

In this connection, it should be kept in mind that the fact that a valid prior disclosure is made will not prevent a criminal prosecution. However, as a matter of practice, most federal prosecutors will not pursue a criminal case against a corporation where the corporation made a prior disclosure. Nevertheless, in making a prior disclosure of a violation that could be deemed to constitute fraud, there is always the possibility that a federal prosecutor will agree to pursue a criminal prosecution.

It is important to note that the program must be effective. An effective program is one that is supervised by upper management, clearly communicated to employees and consistently enforced. An effective compliance program will also include education and training elements, coordination, review and internal audits.

These programs must go beyond the import and traffic departments. Other departments including, but not limited to accounting, controller and purchasing, must be involved in these programs if they are to be effective. In fact, probably the most important aspect of any compliance program is effective

coordination among these and other departments. It is also necessary to conduct periodic compliance audits to ensure that the compliance policy is followed.

In short, a compliance program is not a complete defense to a criminal or civil violation. However, it makes a criminal prosecution much less likely, and will be an important mitigating factor in a civil proceeding.

J. False Claims Act. The number of False Claim Act ("FCA") cases involving customs violations continues to rise. The types of cases vary but valuation and antidumping evasion seem to be the most prominent. We are aware of a pending case involving footwear classification.

The FCA, which has been on the books for over a century, provides that the government can recover triple damages plus penalties for the knowing submission of a false claim. The statute allows the government to sue directly. However, in most cases the claims are initiated by a private party seeking to benefit from whistleblower provisions that award up to 30 percent of the proceeds depending whether the government intervenes in the suit. In fiscal 2017, in excess of 700 such suits were filed by employees and business competitors seeking an edge in the market place or the elimination of unlawful activities that created an unfair advantage to the competitors.

An importer who becomes the subject of an FCA action will find itself in serious straits. These cases are much more involved than the typical customs civil penalty case. Keep in mind that these cases always involve fraud, neither negligence nor gross negligence is sufficient to support an FCA claim. The FCA provides the government with a new avenue to seek redress from importers alleged to have committed customs fraud.

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This memorandum does not address the enhanced enforcement capabilities of CBP in connection with antidumping evasion.

There are no antidumping orders involving footwear. Further, given that an antidumping case may not proceed unless a significant percentage of domestic producers are in favor, a petition involving footwear seems unlikely. This is because there are a few if any domestic producers who are not substantial importers.

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