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The Criminalization of Import Violations by Customs Authorities

Understanding Global Trends in Customs Enforcement

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Topics for Discussion

- Criminalization of Import Violations: An Overview
- Traditional Civil Enforcement Methods in the United States
- Transition to Criminal Prosecutions in the United States
- US Influence on Other Countries
- European Union Enforcement Methods
- Risk Mitigation in a Criminal Context
- Conclusion

Criminalization of Import Violations: An Overview

- All countries have civil and criminal laws enforcing import violations
- What are import violations?
 - Undervaluation of goods upon entry into a customs territory
 - Inaccurate country of origin marking
 - Misclassification of goods
 - Failure to pay antidumping or countervailing duties
- US initiated trend towards criminalization that is influencing other countries

Criminalization of Import Violations: An Overview

- Confluence of events in US has lead to criminalization
 - Public outcry over import safety and duty evasion
 - “Toymaker penalized after magnetic toy death” (Associated Press; April 14, 2009)
 - “Child Safety: Pacifiers and Cribs Recalled” (Injuryboard.com; April 14, 2009)
 - “Tainted Chinese Drywall Contaminating US Homes” (Epoch Times, April 14, 2009)
 - “Honey Laundering? US Indicts 11 Executives for Smuggling Chinese Honey” (cbsnews.com, September 3, 2010)
 - “Supporters Ratchet Up Efforts To Pass AD/CVD Evasion Legislation” (Inside US Trade, March 25, 2011)
 - Loss of Revenue
 - Perception of rampant evasion of US law

Criminalization of Import Violations: An Overview

- Effect has been to cause US Customs to refer more cases to the US Department of Justice for criminal investigation and prosecution
- Expands ability to conduct broad investigations
 - More targets (foreign-based producers and traders; consignees)
 - More theories of culpability and liability (including broad conspiracy statutes; obstruction of justice)
 - Significant prison terms and/or fines
- Onerous and costly for companies that are otherwise not subject to customs investigations

Traditional Civil Enforcement Methods in the United States

- Focus on actions of importer of record
- Must demonstrate reasonable care in entering merchandise
 - Classification of goods
 - Valuation of goods
 - Origin of goods
- Policies and procedures
 - Importers must have written policies
 - Must explain application of procedures in practice

Traditional Civil Enforcement Methods in the United States

- Failure to comply results in penalty proceeding under 19 U.S.C. §1592 – Elements of 1592 Claim:
 - by fraud (i.e., voluntarily and intentionally), gross negligence (i.e., with actual knowledge or wanton disregard), or negligence (i.e., fails to exercise reasonable care),
 - enters or introduces (or attempts to enter or introduce) any merchandise into the commerce of the US,
 - by means of any document or electronically transmitted data or information, written or oral statement, or act which is material and false, or any omission,
 - which is material.

Traditional Civil Enforcement Methods in the United States

- Penalty exposure in §1592 cases
 - Negligence – Range from 0.5 times to 2 times the total duty loss, or 5% to 20% of dutiable value in non-revenue loss cases;
 - Gross negligence – Range from 2.5 times to 4 times the total duty loss, or 25% to 40% of the dutiable value in non-revenue loss cases, but never to exceed the domestic value of the merchandise;
 - Fraud – Range from 5 times to 8 times the total duty loss, or 50% to 80% of the dutiable value in non-revenue loss cases, but never to exceed the domestic value of the merchandise.
- Mitigation – numerous opportunities to lessen penalty through negotiation

Traditional Civil Enforcement Methods in the United States

- Perceived weaknesses with civil enforcement
 - High profile failure to prevent importation of tainted or illegally transshipped goods
 - Loss of revenue
 - Lack of manpower to enforce civil remedies
 - Inability to reach parties outside of jurisdiction
 - Focus on importers of record
- Result – Increase in number of criminal referrals to US DOJ (wire hangers, honey, shrimp)

Transition to Criminal Prosecutions in the United States

- US Criminal Exposure
- Expansive toolbox available to investigators and prosecutors
- Broad statutory provisions
 - 18 USC § 542 (Entry of Goods by Means of False Statements)
 - 18 USC § 545 (Smuggling Goods into the US)
 - 18 USC § 1519 (Destruction, Alteration, or Falsification of Records)
 - 18 USC § 371 (Conspiracy)
 - 18 USC §§ 1341, 1343 (Mail and Wire Fraud)

Transition to Criminal Prosecutions in the United States

- Mutual Legal Assistance Treaties (MLATs)
- International Investigative Tools (ICE agents overseas, cooperation agreements)
- Threat of significant prison time and/or penalties

Transition to Criminal Prosecutions in the United States

- Corporations can be criminally liable based on respondeat superior
 - Certain criminal conduct by employee acting within scope of employment
 - Pressure on corporation to monitor activities of employee
 - Complicates investigation because of potential tension between corporation and employee

Transition to Criminal Prosecutions in the United States

- Statute of limitations may be extended for overseas companies
- Logistics issues regarding internal investigation
 - Language barriers
 - Conduct may not seem illegal in country where investigation may center
 - Documentation, holds, and privacy issues

Transition to Criminal Prosecutions in the United States

- 541 – Entry of Goods Falsely Classified
 - Knowingly effects entry of goods at less than true value (includes weight, measure, classification or quality)
 - Punishment includes fine and up to two years in prison
- 542 – Entry of Goods by Means of False Statements
 - Knowingly introduces or attempts to introduce by means of fraudulent invoice, declaration, affidavit, letter, paper or any false statement
 - May Include in some limited circumstances “Willful blindness”
 - Punishment includes fine and up to two years in prison
- 545 – Smuggling Goods into the US
 - Knowingly and Willfully with intent to defraud the US, or
 - Knowingly imports any banned merchandise into the US
 - Punishment – fine and up to **twenty** years in prison.

Transition to Criminal Prosecutions in the United States

- Conspiracy
 - Agreement between two or more to perform an illegal act
 - An act in furtherance of the agreement
- Wire/Mail Fraud
 - Use of a scheme or artifice to defraud
 - Use of mail and wire can be given wide meaning to include:
 - Payments
 - Ordering
 - Phone calls
 - Internet

Transition to Criminal Prosecutions in the United States

- MLAT

- Mutual Legal Assistance Treaty

- Treaty between the US and other nation
 - Permits various forms of investigations for various crimes
 - Can permit US document requests
 - Can permit US investigators being able to interview

Transition to Criminal Prosecutions in the United States

- Grand Jury Subpoena
 - Issued by US Attorneys Office – US Department of Justice
 - Expansive request for documents and records
 - Third parties may be asked to provide these records
 - Bank Records
 - Invoices, shipping labels, proof of payment
 - Expensive to comply
 - Lengthy
 - Testimony can be demanded

Transition to Criminal Prosecutions in the United States

- *US v. Wolff, et al.* (Northern District of Illinois)
 - the defendants including a German group has been charged with a number of wide ranging criminal violations, including obstruction of justice related to their efforts to circumvent antidumping duties on honey imported from China
 - the *Wolff* defendants have been charged with obstruction of justice and trade offenses
 - Alleged tariff avoidance is in the tens of millions of US dollars
 - Techniques have included obtaining private email accounts of alleged conspirators
 - Arrests have included businessmen and executives
 - While there have been some guilty pleas, trial is pending and the investigation is ongoing

Transition to Criminal Prosecutions in the United States

- Blyth (Alabama)
 - Smuggled seafood, including catfish and shrimp
- Huizar-Velaquez (San Diego)
 - Smuggling wire hangers

US Influence on Other Countries

- US Free Trade Agreements

- Korea, Singapore, Australia, Canada, Mexico, Chile, Columbia, Jordan, Morocco, Oman, Panama, Peru, CAFTA-DR
- “Where a Party has a reasonable suspicion of unlawful activity related to its laws or regulations governing importations, the Party may request the other Party to provide specific confidential information normally collected in connection with the importation of goods.”
- “A Party's request . . . shall be in writing, shall specify the purpose for which the information is sought, and shall identify the requested information with sufficient specificity for the other Party to locate and provide the information.”
- “The Party from which the information is requested shall, in accordance with its law and any relevant international agreements to which it is a party, provide a written response containing the information.” (Korea FTA)

US Influence on Other Countries

- Korea FTA

- June 3, 2011 announcement by Korean Customs Service ("KCS") declaring "measures reinforced to control illegal trans-shipments" to crack-down and punish illegal trans-shipment.
- KCS has established a new bureau to take charge of policy planning for implementation of the FTAs with the EU and USA, with 157 new officers assigned to work exclusively to verify the accuracy of country of origin information for products going to a country with which Korea has an FTA.

US Influence on Other Countries

- CAFTA-DR FTA

- Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic
- CBP authorized to conduct surprise site visits to Central American producers suspected of illegal transshipment
- CAFTA-DR then allows CBP to publish the names of illegal transshippers and undertake a variety of enforcement actions (including barring entry of suspect goods)
- CAFTA-DR contains penalties for illegal transshippers, up to and including jail time

European Union Enforcement Methods

- In fact, there are no EU enforcement methods as there is no unified or even harmonized criminal law at EU level
 - ➔ penalties, fines, criminal offences and criminal procedures are still a matter of the 27 EU Member State laws.
- The currently applicable EU Customs Code does not provide any provision on the criminal sanctioning of customs violation. The Modernized Customs Code (MCC) that should not enter into force until July 2013 only provides for minimum guidance:

European Union Enforcement Methods

- *“Each Member State shall provide for penalties for failure to comply with Community customs legislation. Such penalties shall be effective, proportionate and dissuasive.”*
- As regards administrative penalties, the following is provided:
 - *“Where administrative penalties are applied, they may take, inter alia, one of the following forms, or both:*
 - *(a) a pecuniary charge by the customs authorities, including, where appropriate, a settlement applied in place of and in lieu of a criminal penalty;*
 - *(b) the revocation, suspension or amendment of any authorisation held by the person concerned.”*

European Union Enforcement Methods

- In fact, EU Member States are already expected to abide by these principles as the European Court of Justice has stressed that although the EU Member States are free to choose the most appropriate type of penalty (criminal or non-criminal), the penalty must be effective, deterrent and proportionate (cfr. *Greek Maize Case*, Case 68/88)
- Also, import duties (customs + anti-dumping + countervailing duties) belong to the EU's budget for 75%. Minimum principles to safeguard the financial interests of the EU are set forth in Council Regulation No 2985/95 as follows:

European Union Enforcement Methods

- (i) Intentional irregularities or those caused by negligence may lead to administrative penalties including the payment of an administrative fine, the payment of an amount greater than the amounts wrongly evaded plus interest, the withdrawal of an advantage or authorization
- (ii) Criminal proceedings can also be initiated in which case administrative proceedings shall be ceased until the outcome of the administrative proceeding
- Discussions on actual harmonization of criminal sanctions have nevertheless been ongoing and developments might occur at EU level now that the Lisbon Treaty no longer imposes unanimity for a vote on EU customs penalties

European Union Enforcement Methods

- Generally speaking, the EU Member States have a mixed approach to customs violations involving both administrative investigations leading to administrative fines and criminal investigations leading to criminal sanctions
- Depending on the EU Member State, corporations can be held criminally liable whilst, in other Member States, the criminal investigations are conducted vis-à-vis the individuals with corporate liability

European Union Enforcement Methods

- In reality, this does not mean that there is a relaxed attitude vis-à-vis violations of customs legislation:
 - i) There is indeed administrative cooperation between the EU Member State authorities. Investigations are spurred by the EU Anti-Fraud Unit, OLAF operating in close cooperation with the customs authorities of the EU Member States and going on-the-spot for investigations
 - (ii) As import duties are part of the EU budget, the EU Member States are liable for the correct levying of the customs duties and, if they fail to proceed with the levying of customs duties, they may be held liable by the EU. Even though the administrative fines are not settled to the EU and are kept by the EU Member States, the investigations into the import duties themselves, spurs also the application of the penalties provided in EU Member State law
 - (iii) One can in some EU Member States negotiate with the customs authorities about the level of the administrative fine when accepting an amicable settlement but that does not apply to the interests over the unpaid customs duties that can raise significant amounts

European Union Enforcement Methods

- **The UK – HMRC Notice 301**

- In principle, all customs offences are criminal but the UK introduced parallel civil offences for each criminal offence. Based on the notice, criminal investigations will be limited to exceptional circumstances:
 - “To encourage compliance with customs law. We are obliged under EC agreements to promote compliance with Community provisions and to have arrangements in place to counter non-compliance. The UK has relied on criminal sanctions but these have proved cumbersome to operate and can result in those involved getting a criminal record for relatively minor offences. Civil penalties operate in VAT and Excise, as well as in direct taxation, and are seen as an appropriate sanction in most cases. Prosecution remains an option in exceptional circumstances.

We are retaining our statutory powers to seize goods, although where this is done we would not normally charge a civil penalty.”

European Union Enforcement Methods

- The administrative penalties are:
 - maximum of £2,500 per contravention for the more significant irregularities; and
 - maximum of £1,000 per contravention for others.
- No penalty if the importer discovers and discloses a contravention voluntarily.
- No liability for a penalty if there is a reasonable excuse for lack of compliance; this is determined by looking at the circumstances of each case.

European Union Enforcement Methods

- **Germany – primarily “Abgabeordnung”**
 - The law provides both for criminal proceedings including the possibility to impose imprisonment in the most serious cases of tax evasion and for administrative proceedings leading to the imposition of administrative fines. Administrative fines apply in the case of tax offences including when a person intentionally or through negligence contravenes customs regulations and issues documents which are factually incorrect. Depending on the case concerned, the fine can range from EUR 5,000 to EUR 50,000

European Union Enforcement Methods

- Voluntary disclosure in the case of tax offences before notification of the initiation of an investigation can waive the sanctioning
- In the case of tax fraud, new provisions apply since May 2011 and there are still interpretative issues that make it difficult to assess whether voluntary disclosure is favorable.

European Union Enforcement Methods

- **Belgium (General law on customs and excise)**
 - The law provides for fines, imprisonment as well as confiscation. The fines can go up to 10 times the duties evaded depending on the type of offence concerned.
 - Generally speaking, the customs authorities opt for administrative fines and offer transactions. The decision to turn to criminal investigations is largely in the hands of Customs.

European Union Enforcement Methods

- Generally speaking, the sanctioning of customs violations in the EU still rests on provisions that allow criminalization. However, generally speaking, while customs infringements are actively pursued, the preference is still for administrative fines unless in the serious cases such as for example willful falsification of documents.

European Union Enforcement Methods

- There are some provisions in the FTA concluded by the EU regarding penalties, e.g.:
 - (i) Article 29 of the Origin Protocol of the EU – Korea FTA
 - *“Penalties shall be imposed in accordance with the legislation of the Parties on any person who draws up, or causes to be drawn up, a document which contains incorrect information for the purpose of obtaining preferential treatment for products.”*
 - (ii) Article 33 of Annex III to the EU – Chile FTA
 - *“Penalties may be imposed in accordance with internal legislation for infringement to provisions of this Annex. In particular, penalties shall be imposed on any person who draws up, or causes to be drawn up, a document which contains incorrect information for the purpose of obtaining a preferential treatment for products.”*

European Union Enforcement Methods

- (iii) Article 34 of the Origin Protocol of the Association Agreement between the EU and Korea
 - *“Penalties shall be imposed on any person who draws up, or causes to be drawn up, a document which contains incorrect information for the purpose of obtaining a preferential treatment for products.”*
- Thus, the EU’s free trade agreements include a general provision by which the contracting parties make sure that they sanction violations whereby tariff preferences are invalidly afforded.

European Union Enforcement Methods

- In practice, the EU authorities have actively worked with third countries for the proper implementation of the relevant origin requirements (including also in relation to the implementation of its GSP regime) including through on-site investigations by EU Member State and OLAF representatives, the post-clearance recovery of customs duties (+ as relevant interests) and the imposition of fines. Most often this has not led to criminal investigations or imprisonment unless in the most serious cases of fraud or contraband.

Risk Mitigation in a Criminal Context

- Enhanced training and certifications
- Expertise employed
- Updated policies and procedures
- Monitoring procedures to ascertain reliability

Risk Mitigation in a Criminal Context

- Self Disclosure: Whether to Voluntarily Disclose
- Why Disclose?
 - Minimize punishment/
avoid criminal charges
 - Limit civil charges
 - Limit adverse administrative
results
 - Reduce Litigation Risk
 - Part of Proactive Strategy
- Why Not Disclose?
 - Allegation not yet
substantiated
 - Trigger government
investigation
 - Negative publicity
 - Waiver of privilege

Conclusion

- Violations of customs or regulatory provisions at customs clearance are taken very seriously by US and EU authorities and their sanctioning is actively pursued on both sides of the Atlantic even though on the EU side there is not the same tendency (yet) to proceed with criminal investigations and penalties other than in the most serious of cases.
- With (i) the increase in free trade agreements whereby tariff preferences hinge on the origin status of goods and, to some extent, their proper tariff classification and (ii) the increase outside the US and the EU of trade remedy such as anti-dumping measures, authorities will more actively pursue the underpayment of import duties also outside the US and the EU. Domestic industry will obviously be keen to draw the attention of local customs authorities when they suspect violations.
- Increased attention towards compliance and compliance procedures is recommended. Given that importers of record are the first target of both criminal and administrative investigations and will bear the brunt of any sanction imposed, they would be well advised to monitor their suppliers' compliance with customs and other regulations as well.

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