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# Update on the Criminalization of Customs Violations and the Rise of False Claims Act Claims Alleging Customs Violations

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## Presenters:

Kelly B. Kramer

[kkramer@mayerbrown.com](mailto:kkramer@mayerbrown.com)

Sydney H. Mintzer

[smintzer@mayerbrown.com](mailto:smintzer@mayerbrown.com)

# Speakers



Kelly B. Kramer  
Washington DC  
+1 202 263 3007  
kkramer@mayerbrown.com



Sydney H. Mintzer  
Washington DC  
+1 202 263 3866  
smintzer@mayerbrown.com

# Topics for Discussion

- Criminalization of Customs Violations: An Overview
  - Traditional civil enforcement methods in the United States
  - Transition to criminal prosecutions in the United States
  - Recent criminal prosecutions
- The Growing Use of the False Claims Act
  - Recent False Claims Act cases
- Risk Mitigation
- Conclusion

# Criminalization of Customs Violations: An Overview

- The US has civil and criminal laws enforcing customs violations
- What are customs violations?
  - Undervaluation of goods upon entry into a customs territory
  - Inaccurate country of origin marking
  - Misclassification of goods
  - Failure to pay anti-dumping or countervailing duties

# Criminalization of Customs 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 Customs Violations: An Overview

- Customs is referring more cases to the 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)

# The Criminalization of Customs Law

- Implications of Criminalization
  - Criminal authorities have enhanced investigative tools
  - Broader group of potential defendants
  - Harsher sanctions, including potential for prison terms
  - Wider range of potential theories of liability
  - Higher compliance costs

# The Criminalization of Customs Law: Enhanced Investigative Tools

- Grand jury subpoena
  - Issued by Department of Justice
    - Potentially expansive request for documents and records
      - Third parties, including banks, may be asked to provide records
      - E-mails, invoices, shipping labels, proof of payment
    - In-person testimony can be demanded
  - High compliance costs

# The Criminalization of Customs Law: Enhanced Investigative Tools

- International investigations
  - MLATs
    - Treaties between the US and other nations
    - Permit various forms of investigations for various crimes
    - Can include document requests
    - Can allow US investigators to interview subjects overseas
    - Can extend statute of limitations

# The Criminalization of Customs Law: Broader Group of Potential Defendants

- Corporate and personal exposure
  - Corporations and executives face threat of prison time, fines and/or forfeitures
  - Corporate liability based on *respondeat superior*
    - Criminal conduct by employee acting within scope of employment
    - Underscores importance of compliance program
  - Executives face individual criminal liability

# The Criminalization of Customs Law: Potential Statutes

- Broad statutory provisions
  - 18 USC § 541 (Entry of Goods by Means of False Statements)
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  - 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)
  - 18 USC §§ 1956, 1957 (Money Laundering)

# The Criminalization of Customs Law: Targeted Statutes

- 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



# The Criminalization of Customs Law: Key Statutes in Recent Cases

- Obstruction (1519)
  - Knowingly alters or makes a false entry in any document with the intent to impede the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States
  - No requirement that action be intended to obstruct any particular investigation
  - Punishment – fine and up to **twenty** years in prison
- Conspiracy (371)
  - Agreement between two or more to perform an illegal act; or
  - Agreement between two or more people to defraud the United States; and
  - An act in furtherance of the agreement

# The Criminalization of Customs Law: Possible Future Theories

- Wire/Mail Fraud (1341 & 1343)
  - Use of a scheme or artifice to defraud
  - Use of the mails or the wires “in furtherance” of the fraud
  - Use of mail and wire is given wide meaning to include:
    - Payments; ordering; phone calls; e-mails; Internet
- Money Laundering (1956 & 1957)
  - Concealment of criminal proceeds or promotion of criminal conduct
  - Spending criminal proceeds

## Recent Criminal Cases

- *United States v. Wolff, et al.* – “Honey Laundering”
  - New enforcement paradigm: Criminal charges alleging a global conspiracy to evade nearly \$80 million in anti-dumping duties by transshipping Chinese honey through third countries
    - Anti-dumping duties have been in place on imports of honey from China since 2001, with duties as high as 221%
    - Defendants allegedly falsified US Customs entry forms and sales documentation; sought out customers that did not adequately test products; and instructed co-conspirators not to write or to delete emails about their activities

# Recent Criminal Cases

- *United States v. Wolff, et al.* – “Honey Laundering”
  - Corporate pleas
    - Two US-based executives pled guilty and cooperated
      - Recently sentenced to year-and-a-day jail term or probation
      - Both faced dramatically harsher sentences (46-57 months) absent cooperation
    - German-based executives never appeared in US court
      - All are now fugitives potentially subject to arrest and extradition

## Recent Criminal Cases

- *United States v. Chen* (N.D. Ga. 2012)
  - Newly-filed criminal case against paper supply company and its top executives, as well as Chinese paper manufacturers
  - Government alleges that paper manufacturers bribed Taiwanese inspectors and conspired with importers to avoid anti-dumping duties by falsely labeling paper with “Made in Taiwan” stickers
  - Scheme allegedly unraveled when importer fired CEO’s “paramour,” who delivered a hard drive to the Department of Homeland Security

## Recent Criminal Cases

- *United States v. Chavez, et al.* (S.D. Cal. 2012)
  - Follows the *Wolff* model: Broad criminal charges for alleged customs violations
  - Defendants allegedly avoided customs duties on Chinese-made textiles and other goods by falsely claiming that they would not be sold in the United States
  - One defendant has pled guilty; the charges against the others remain pending

## Recent Criminal Cases

- *United States v. Fai Po* (D. Ak. 2012)
  - Focus on foreign exporter – Defendant foreign exporter plead to undervaluing jewelry on invoices used for customs clearance under 18 USC § 545
  - Defendant had no contacts with the US other than via jewelry shipments to US consignees. Shipping company was the importer of record
  - Pled guilty to one count. Sentenced to probation and to pay \$800,000 fine and \$1 million in back duties.

# The Growing Use of the False Claims Act

- The False Claims Act (31 USC § 3729) creates liability against any person who:
  - Knowingly submits a false claim to the government;
  - Knowingly makes a false record or statement to get a false claim paid by the government;
  - Knowingly acts to avoid having to pay money to the government; or
  - Conspires with another to violate the FCA



# The Growing Use of the False Claims Act

- Substantial penalties:
  - Treble damages (i.e., three times actual damages)
  - Fines of \$5,500 to \$11,000 for each false claim
- *Qui tam* provisions
  - Allows private persons to sue on the government's behalf
  - Such suits are known as “*qui tam*” actions; the plaintiff is termed a “relator”
  - Relators are generally entitled to portion of any recovery, as well as legal fees and expenses

# The Growing Use of the False Claims Act

- *Qui tam* actions are filed under seal – triggers government investigation – government may either:
  - Intervene in the action (i.e., take over the case); or
  - Decline to intervene, thus allowing the relator to proceed
- Relator's recovery varies with intervention decision:
  - 15 to 25 percent when government intervenes;
  - 25 to 30 percent when the government does not

# The Growing Use of the False Claims Act

- Relator provisions create many potential plaintiffs:
  - Competitors
  - Employees (including compliance employees)
  - Contractors
  - All with monetary incentives to file suits
- Whistleblower suits are now generating large settlements and criminal investigations

## Recent False Claims Act Cases

- *United States v. CMAI Industries* (E.D. Mich., Settled September 2012)
  - Auto parts importer: Pled guilty to misclassifying auto manifolds in customs paperwork despite charging its customers (American car makers) the proper duty (2.5%) – thus evading \$2.5 million in duties
  - Criminal sentence: \$25,000 fine; two years probation
  - False Claims Act settlement: \$6.3 million
  - Entire investigation premised on a whistleblower complaint

## Recent False Claims Act Cases: Traditional Customs Violations

- *United States v. Premier Manufacturing Inc.* (D.S.C. 2007)
  - Cigarette importer: Understated weights of cigarettes to avoid customs duties
  - Company pled guilty to offense in 2005; agreed to pay \$7.6 million to resolve the criminal claims
  - Notwithstanding the criminal settlement, DOJ continued its civil FCA investigation. In 2007, importer agreed to pay an additional \$3.1 million to resolve the DOJ's civil FCA and customs-based claims

## Recent False Claims Act Cases: Traditional Customs Violations

- *United States v. Intertex Apparel* (S.D.N.Y., June 2008)
  - Misrepresenting country of origin for apparel; understating value of imports
  - Investigation prompted by whistleblower; government intervened
  - False Claims Act settlement: \$2.8 million

## Recent False Claims Act Cases: Traditional Customs Violations

- *United States v. Noble Jewelry* (S.D.N.Y., Aug. 2011)
  - Importer of jewelry – routinely presented government with invoices understating the value of the jewelry; maintained separate books with true value
  - Investigation prompted by whistleblower; government intervened. False Claims Act Settlement: \$3.5 million
  - Whistleblower received 19% of recovery – just over \$730,000

## Recent False Claims Act Cases: Anti-Dumping Evasion Claims

- *United States v. Bank of China* (S.D.N.Y. 2003)
  - United States sued mushroom importers who transshipped Chilean mushrooms through Canada to avoid antidumping and customs duties
  - Bank of China, which financed the operations, also named as a FCA defendant
  - Bank denied all liability, but settled for \$5.25 million



## Recent False Claims Act Cases: Anti-Dumping Evasion Claims

- *United States v. Toyo Ink Manufacturing* (W.D.N.C., April 25, 2012)
  - Manufacturer of printing ink; allegedly sought to avoid anti-dumping and countervailing duties by listing Mexico as country-of-origin for Chinese-origin pigments
  - Claimed damages in excess of \$45 million; treble damages could run as high as \$135 million
  - **Investigation prompted by *competitor* complaint** (only US manufacturer of pigment); government intervened

## Recent False Claims Act Cases: Anti-Dumping Evasion Claims

- *Doe v. Staples, Inc., et al.*, No. 08-cv-00846-RJL (D.D.C.)
  - *Qui tam* action against Target, Office Max, Staples
  - Alleges that companies knowingly imported Chinese pencils that had been transshipped through other countries to avoid anti-dumping duties
  - DOJ investigated for four years, but declined to intervene
  - *Qui tam* plaintiff proceeding; claims are subject to pending motions to dismiss

# Risk Mitigation – Preventing a Problem

- Basic elements of a global compliance system
  - Corporate commitment
  - Management involvement
  - Policies, processes, procedures and recordkeeping
  - Risk assessment
  - Strategic relationships

# Risk Mitigation – Reacting to a Problem

- Traditional approach – Prior disclosure under customs regulations
- Considerations in light of recent trends
- Why disclose?
  - Minimize punishment/avoid criminal charges; limit civil or administrative charges; part of proactive strategy
- Why not disclose?
  - Allegations not yet substantiated; likely to trigger government investigation; likely to generate negative publicity; potential to waive privilege

# Conclusion

- Criminal investigations of customs violations continue unabated, and traditional methods of compliance that focus only on traditional civil methods of enforcement overlook significant risks to corporations and individuals
- US Customs is referring more types of customs violations to the US Attorneys' Office. Many early cases involved alleged evasion of anti-dumping duties and of health and safety measures. More recently, traditional customs violations (i.e., undervaluation of goods) are being referred to the US Attorneys' Office, even in cases where criminal activity was difficult to ascertain
- The False Claims Act now presents another novel approach to combating alleged customs violations. The FCA's *qui tam* and treble damages provisions significantly increase both the likelihood of an enforcement action and the potential financial penalties. Moreover, whistleblower reports under the FCA are increasing leading to federal criminal investigations
- The heightened risk of allegations raised under criminal laws and the FCA broadens the number of parties that can become the target of customs violation claims and ratchets up the pressure to enhance corporate policies that specifically address customs compliance

# Questions

- Please use the Q&A panel on the right side of your screen to submit a question.

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