"Inc." No Longer a Safe Shield – Federal Circuit Greatly Expands Officer/Shareholder Liability Resulting from US Customs Violations

On September 16, 2014, an en banc panel of the US Court of Appeals for the Federal Circuit (the "En Banc Panel") issued a far-reaching decision, *Trek Leather III*,[1] greatly expanding corporate shareholders' and officers' potential liability for customs violations. It reversed *Trek Leather II*[2] issued by a three-judge panel of the Federal Circuit in July 2013, which had faulted the lower court decision ("*Trek Leather I*")[3] as overly broad in extending liability beyond importers of record.

Trek Leather arose from Trek Leather Inc.'s ("Trek") importation of men's suits between February 2, 2004, and October 8, 2004. By undervaluing the merchandise in import documentations submitted to the US Customs and Border Protection ("CBP"), Trek underpaid customs duties. Trek, the corporation, was the importer of record for all relevant import transactions, but also implicated in this case is Trek's president and sole shareholder, Harish Shadadpuri. For more background on the *Trek Leather* litigation, please see our prior legal update, "'Inc.' No Longer a Shield? – Federal Circuit May Expand Officer/Shareholder Liability Resulting from US Customs Violations."

19 U.S.C. § 1592 is the main statute at issue in *Trek Leather*. Civil penalties for customs violations are typically imposed under this statute. It provides, in relevant part:

> Without regard to whether the United States is or may be deprived of all or a portion of any lawful duty, tax, or fee thereby, no person, by fraud, gross negligence, or negligence—
>
> A) may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of—
>
> i. any document or electronically transmitted data or information, written or oral statement, or act which is material and false, or
>
> ii. any omission which is material, or
>
> B) may aid or abet any other person to violate subparagraph (A).

19 U.S.C. § 1592 (a)(1). The civil penalties, in turn, are provided in 19 U.S.C. § 1592(c). Section 1592 is commonly used to target importers of record for improper entries, because related statutes under Title 19 directly impose a duty of reasonable care on parties acting in such capacity.[4] It is also clear that, when an importer of record is a corporation, personal liability can be pursued under an "aiding or abetting" theory as provided in subparagraph (B), or based on the common law principle of "piercing the corporate veil."

In *Trek Leather III*, whether the underlying customs violation is one targeted by section 1592(a)(1)(A) is not in dispute. That is, the

parties agreed that certain import-related actions by fraud, gross negligence or negligence through material false statement or material omission are present. The only real issue before the En Banc Panel is whether a person other than the importer of record may be held directly liable for such a violation under subparagraph (A). This is an issue with wide-ranging and significant implications.

For example, both "aiding or abetting" and "piercing the corporate veil" are ancillary theories of liability premised on another party's violation, and they each set additional legal hurdles to imposing personal liability when the importer of record is a corporation. In general, aiding-or-abetting liability must be supported by a fraud claim, which requires "knowledge" of the violator—a heightened standard for culpability not necessary for a gross negligence or negligence claim. And the "piercing the corporate veil" principle requires multiple common law elements extraneous to customs laws and is often a contentious issue with complex factual questions. Therefore, if the En Banc Panel had found that a person other than the importer of record may be directly liable under section 1592(a)(1)(A), as they did in *Trek Leather III*, the government's burden in pursing other individuals and entities involved in the import process would be reduced significantly.

In *Trek Leather III*, the government, in fact, neither pressed any claim for aiding-or-abetting liability nor sought to pierce the corporate veil separating Trek and Mr. Shadadpuri. As the En Banc Panel found, the only questions presented for decision were: (1) whether Mr. Shadadpuri is a "person" covered by section 1592(a)(1)(A), and (2) whether his actions come within the "enter, introduce, or attempt to enter or introduce" language of that provision. That is, on this appeal the government's only theory of liability is that Mr. Shadadpuri violated section 1592(a)(1)(A) as a "person" covered by the statute through his own relevant conduct, independent of Trek's violation in acting as the importer of record.

The En Banc Panel first held:

> The threshold issue is straightforward. Mr. Shadadpuri is indisputably a "person," and section 1592(a)(1)—including both of its subparagraphs, (A) and (B)—applies by its terms to any "person." There is simply no basis for giving an artificially limited meaning to this most encompassing of terms, which plainly covers a human being.[5]

In doing so, the Panel relied on a US Supreme Court decision issued in 1909, *United States v. Mescall*.[6] At issue in *Mescall* was a predecessor of section 1592, which covered an "owner, importer, consignee, agent, *or other person*." In *Mescall*, as summarized by the En Banc Panel, the Supreme Court rejected a district court's holding that the predecessor statute was limited in its reach to a particular subset of persons, namely, those who make entries, because under the principle of *ejusdem generis* ("of the same kind"), the general term "person" should be narrowly construed on the basis of the preceding terms naming specific parties.[7] In sum, the En Banc Panel affirmed an exceedingly broad interpretation of a "person" subject to section 1592(a)(1)(A). This is evident from the following comment from the panel regarding a 1978 statutory amendment:

> That simplification certainly does not suggest a narrowing; if anything, by removing the textual basis for an *ejusdem generis* argument, it would have suggested a broadening, <u>if any broadening had remained possible after *Mescall*</u>.[8]

The En Banc Panel, then, went on to address a related issue, whether Mr. Shadadpuri's conduct comes within the proscribed actions of section 1592(a)(1)(A). The issue arose in part because the government neither focused on the "introduce" langue in subparagraph (A) before

the CIT nor in their briefs on appeal. Also, 19 U.S.C. § 1484 provides that only certain qualified parties acting as the importer of record may "enter" merchandise into US commerce. Thus, the defendant argued that, when the term "enter" or "attempt to enter" in subparagraph (A) is invoked, only the importer of record may engage in the prohibited conduct and therefore be held liable for direct violation of that subparagraph.

Rather than grapple with the term "enter" and its lawful reach, the En Ban Panel found:

> We need not and do not decide whether Mr. Shadadpuri attempted to or did "enter" the merchandise at issue, and we therefore do not address the relevance to that question of statutory limitations on what persons are authorized to "enter" merchandise under 19 U.S.C. § 1484. We rely instead on the "introduce" language of section 1592(a)(1)(A). Controlling precedent has long established that "introduce" gives the statute a breadth that does not depend on resolving the issues that "enter" raises. And the term "introduce" readily covers the conduct of Mr. Shadadpuri.[9]

Relying on yet another Supreme Court case from 1913, *United States v. 25 Packages of Panama Hats*,[10] the En Banc Panel affirmed, without defining the exact scope of "introduce," that the term encompasses a wide range of conduct related to the import process, some of which may predate the making of a formal entry:

> *Panama Hats* confirms that, whatever the full scope of "enter" may be, "introduce" in section 1592(a)(1)(A) means that the statute is broad enough to reach acts beyond the act of filing with customs officials papers that "enter" goods into United States commerce. *Panama Hats* establishes that "introduce" is a flexible and broad term added to ensure that the statute was not restricted to the "technical" process of "entering" goods. It is broad enough to cover, among other things, actions completed before any formal entry filings made to effectuate release of imported goods …. [11]

Specifically, the En Banc Panel found that Mr. Shadadpuri's following conduct "comes within the commonsense, flexible understanding of the 'introduce' language of section 1592(a)(1)(A)":

> He "imported men's suits through one or more of his companies." While suits invoiced to one company were in transit, he "caused the shipments of the imported merchandise to be transferred" to Trek by "direct[ing]" the customs broker to make the transfer. Himself and through his aides, he sent manufacturers' invoices to the customs broker for the broker's use in completing the entry filings to secure release of the merchandise from CBP custody into United States commerce. By this activity, he did everything short of the final step of preparing the CBP Form 7501s and submitting them and other required papers to make formal entry. He thereby "introduced" the suits into United States commerce.[12]

Trek Leather III is no doubt is a very broad ruling. Its seemingly ordinary reasoning and findings strip away certain commonly expected protections in the import community. First, the formality of making an import entry can no longer shield parties not acting as the importer of record from gross negligence or negligence liability. Unlike aiding-or-abetting liability, "knowledge" is not necessarily required for a gross negligence or negligence claim. Contrary to the common sentiment of "reasonable care" being expected only from the importer of record, the broad interpretations from the En Banc Panel, in theory, have subjected any party privy to the import process to the prohibition on

negligent entries, which are remote from and more common than fraudulent conduct.

Equally important, it is commonly understood that incorporation creates a legal person separate from natural persons in the eyes of law. Thus, incorporation affords certain protections to shareholders, directors and senior officers and other employees when they act on behalf of the corporation. However, analogizing to a principle for tort liabilities under agency law—an agent who actually commits a tort is generally liable for the tort along with the principal, even though the agent was acting for the principal—the En Banc Panel noted emphatically:

> We do not hold Mr. Shadadpuri liable because of his prominent officer or owner status in a corporation that committed a subparagraph (A) violation. We hold him liable because he personally committed a violation of subparagraph (A).[13]

The En Banc Panel's finding adds section 1592(a)(1)(A) to the list of nonfeasance for which personal liability may be pursued without "piercing the corporate veil," which necessitates proving that the natural person acted as an alter ego of the corporation. After *Trek Leather III*, the government may go after *any* employee—irrespective of his or her position—of a corporate importer of record personally under section 1592(a)(1)(A), even if the person's involvement in the import procedures is a result of his or her performing official duties on behalf of the corporation.

All "persons," whether individuals or entities, involved in importing merchandise into the United States should note the remarkable breadth of *Trek Leather III*. As clarified by the En Banc Panel, the focus of section 1592(a)(1)(A) is not who has the authority and is the person who formally enters the merchandise into US commerce. Rather, any person who *directly participates* in the import process now may be held personally liable for simple negligence under the "introduce" language of section 1592(a)(1)(A). That is, after *Trek Leather III*, the formality of acting as the importer of record is neither a shield to other parties that may be intimately involved in submitting a formal entry to the CBP, such as a consignee (i.e., the ultimate purchaser), nor to the employees of a corporate importer of record. The risks to a corporate importer of record's shareholders and officers are particularly high, because their arguments premised on the "corporate shield" have been specifically examined and rejected, although the decision, on its own terms, goes beyond these corporate constituencies.

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Endnotes

[1] *Trek Leather Inc. et al. v. United States*, No. 09-CV-0041 (Fed. Cir., September 16, 2014) (*en banc*).

[2] *Trek Leather Inc. et al. v. United States*, No. 09-CV-0041 (Fed. Cir., July 30, 2013), *rev'd by* Trek Leather III.

[3] *Trek Leather Inc. et al. v. United States* , No. 09-00041, slip op. (Ct. Int'l Trade June 15, 2011). The lower court referred to in this legal update is the US Court of International Trade ("CIT").

[4] 19 U.S.C. §§ 1484, 1485.

[5] Trek Leather III, court opinion at 13.

[6] 215 U.S. 26 (1909).

[7] Trek Leather III, court opinion at 13–14.

[8] *Id.*, court option at 14 (emphasis added).

[9] *Id.* court option at 15–16.

[10] 231 U.S. 358 (1913).

[11] Trek Leather III, court opinion at 18.

[12] *Id.*, court opinion at 19.

[13] *Id.*, court opinion at 20.