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A Reminder That FCA Can Be Used For Customs Enforcement

Law360, New York (January 30, 2014, 1:55 PM ET) -- On Nov. 14, 2013, the U.S. Department of Justice announced a False Claims Act settlement with Basco Manufacturing Company, a maker of shower enclosures, for $1.1 million related to misstatements on U.S. Customs and Border Protection entry forms. The alleged misstatements were intended to allow the company to avoid anti-dumping duties (ADD) and countervailing duties (CVD) on aluminum extrusions used in its products that were actually from China, but transshipped through Malaysia in an attempt to avoid the duties.

The settlement against Basco does not resolve the entire matter, as Basco was one company of many involved in an alleged conspiracy to conceal the Chinese origin of the aluminum extrusions at issue. Aspects of the settlement highlight certain risks posed by the False Claims Act that compound general U.S. enforcement of trade laws, and a reminder that diversion for inbound products to the United States may be a significant compliance issue of which companies should be aware.

Background

ADD and CVD

Anti-dumping and countervailing duties are imposed on products from countries found to have been engaging in unfair trade practices by the U.S. Department of Commerce and U.S. International Trade Commission. ADD apply where a company is found to dump its goods on the U.S. market below fair value. CVD apply where a company is found to have received unfair government subsidies. ADD and CVD can be substantial, with duty rates of over 100 percent in addition to the tariffs charged on the goods at issue.

Because of the high margins of ADD and CVD, in some instances importers have sought to avoid ADD and CVD by transshipping goods through third countries, concealing their country of origin by presenting documents showing the country of transshipment as the country of origin, even where the goods did not qualify for that status.

The False Claims Act

The False Claims Act, 31 U.S.C. §§ 3729-33, has been around for over 150 years, and provides that the government can recover treble damages plus penalties against contractors for the knowing submission of a false claim for payment. While the statute allows the government to sue contractors directly, these claims are often initiated by private parties as a qui tam action seeking to benefit from the statute's whistleblower rewards (up to 30 percent of the proceeds, depending on whether the government intervenes in the suit). In fiscal year 2012 alone, 647 qui tam suits were filed under the FCA, not only by disgruntled employees seeking a financial windfall, but also by business competitors seeking an edge in the marketplace.

Despite the law's lengthy history, only recently has the government begun to use the FCA to sue for compliance lapses relating to international trade regulations. The government has taken the position, successfully, that a contractor's failure to identify correctly a product's country of origin, and thereby avoid paying anti-dumping and countervailing duties, constitutes a false claim under the FCA. These types of cases, in which the false statement is used to avoid a liability and not secure an affirmative payment from the government, are colloquially described as "reverse false claims."

In December 2012, Japanese-based printing ink manufacturer Toyo Ink SC Holdings Co. Ltd. agreed to a $45 million settlement of FCA allegations levied against it by the DOJ under this theory of liability. Given its success, the DOJ has continued to pursue these actions, either directly or by intervening in qui tam actions, as an additional method to enforce international trade regulations.

The Allegations

The alleged conspiracy in this matter involved a group of U.S. companies involved in manufacturing shower enclosures that had purchased aluminum extrusions from a company in China. When anti-dumping and countervailing duties went into effect against aluminum extrusions from China in 2010, the Chinese company allegedly began to transship its products through Malaysia, no longer listing the country of origin on documents related to the products. The international sales director for the Chinese supplier allegedly informed its customers of details related to how the shipments would change, and in some instances charged those customers a 12 percent surcharge to cover the cost of transshipping the products through Malaysia.

The complaint was filed by a relator on behalf of the United States. That relator is the owner and CEO of a company that aids U.S. companies in finding sources of aluminum extrusions and other products abroad.

Analysis

The use of the False Claims Act to prosecute customs fraud is not novel, but this case highlights a few flashpoints for the government's use of the statute in the area of customs enforcement.

The government has means to prosecute customs violations other than through the FCA whistleblower provisions. For example, CBP can investigate country of origin fraud independently through details such as the fact, alleged in the Basco case, that the Chinese company had no manufacturing operations in Malaysia at the time it was purporting to import Malaysian-origin products.

However, the whistleblower provisions of the FCA create significant additional means through which the Department of Justice can uncover and investigate customs inaccuracies. The fact that the relator in this matter was a U.S. entity involved in the business makes clear that whistleblowing may be attractive not only because of the potential monetary reward from the government, but also to gain a business advantage (or, alternately, remove an ostensibly unfair advantage).

The settlement also highlights how the government may use a common party to investigate the operations of several companies (or entire industries). Here, the operations of one Chinese supplier to transship through Malaysia had ramifications for all of its U.S. customers — although the customers were allegedly aware of and either explicitly or implicitly agreed to the new operations.

The matter brings to mind recent investigations brought by the U.S. Department of Justice and the U.S. Securities and Exchange Commission involving the Foreign Corrupt Practices Act, where the government has branched out from investigations of a single company to identify problems with similarly situated companies in the same industry. There, the government tends to learn from patterns of fraud it finds in one case and make inquiries with other companies based on that information. It seems feasible given the targeted nature of ADD and CVD that CBP could apply the same tactic to investigating potential diversion of aluminum extrusions from China.

Although this case involved an alleged conspiracy willfully to avoid customs duties, it also highlights potential risk areas for companies that do not have targeted import compliance programs. As has been the case in the FCPA, U.S. companies may receive government inquiries for being involved with third parties conducting illicit activities. For those companies, proving the absence of intent can be a challenge.

It is therefore a good idea for companies proactively to identify potential risk areas for ADD and CVD evasion and take measures to manage that risk. Knowing the details of major suppliers' operations is a key aspect of this practice, as is affirmatively identifying those goods that are used by the company that are subject to ADD and CVD. Where goods might be subject to transshipment, companies should perform reasonable diligence on the goods. Having reasonable compliance mechanisms in place can help companies to manage their supply chain and avoid later unpleasant surprises.

Conclusion

The Basco settlement, while small relative to some recent FCA cases, highlights some of the important issues facing companies in customs compliance that are compounded by the U.S. government's use of the False Claims Act in this area. By being aware of the risks of inbound diversion and country of origin falsification, companies can position themselves to take appropriate measures and avoid extensive investigations and costly penalties.

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